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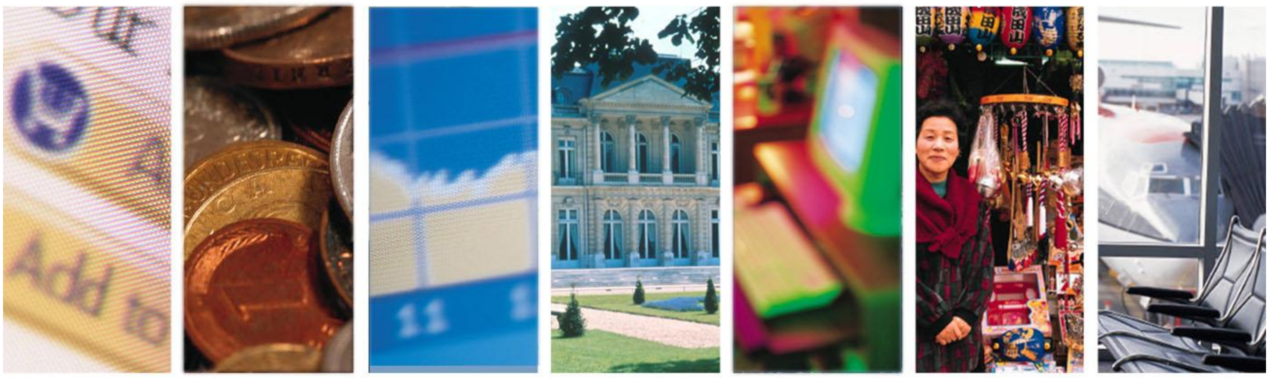

REPORT ON TAX FRAUD AND MONEY LAUNDERING VULNERABILITIES INVOLVING THE REAL ESTATE SECTOR

CENTRE FOR TAX POLICY AND ADMINISTRATION

EXECUTIVE SUMMARY

This report contains information on the tax evasion and money laundering vulnerabilities associated with the real estate sector. The information contained in the report was provided by 18 countries represented in the Sub-Group in response to a questionnaire that was sent to delegates in July 2006. Apart from providing a useful overview of the key tax evasion and money laundering issues and risks associated with the real estate sector, the report is also intended to provide practical guidance to tax authorities that are seeking to implement or refine strategies to effectively address these risks.

The key findings are as follows:

- In most of the countries surveyed, the real estate sector has been identified as an important sector being used to facilitate tax fraud and money laundering. There are no reported official figures or statistics about the dimension of the problem; one country, Austria, has reported an estimation of the amount of fraud involving the real estate sector of approximately € 70 million.

- The countries reported that the three most common methods and schemes used are: price manipulation (escalating prices make it easier to manipulate prices of properties and transactions), undeclared income / transactions and the use of nominees and/or false identities, and corporations or trusts to hide the identity of the beneficial owners.

- The method of concealing ownership has three main variations: a) onshore acquisitions through off-shores companies and/or through a complex structure of ownership; b) unreported acquisition of properties overseas; and c) use of nominees.

- There is no single specific technique or strategy typically employed to identify taxpayers that use the real estate sector to commit tax fraud and money laundering. Traditional techniques based on risk analysis, risk profiling and case selection (with or without data matching or cross-checking information techniques) coexist with other more advanced and contemporary tools such as statistical analysis and data mining.

- Even in those countries with a systematic approach to identifying and detecting suspected cases of money laundering and tax fraud in the real estate sector, there is not always an evaluation of the results achieved, since the totality of the problem is often unknown.

- The report contains a stock-take of red flag indicators used by tax authorities to detect tax fraud and money laundering in the real estate sector and has classified these in four different groups: data discrepancies, individual characteristics and behaviour, financial analysis and document and business operation.

- The most common investigation methods have been: targeted and random audits; fraud investigations (that may include undercover operations) and multi-agency operations. Most countries reported that multi-agency co-operation was highly important and three basic models have been identified: tax agencies and other law enforcement agencies working in partnership (and sometimes seconding staff); tax agencies and other law enforcement agencies working in parallel; and the model of law enforcement agencies other that tax agencies with exclusive jurisdiction in the predicate offence.

- The strategies implemented by tax authorities to promote tax compliance can be classified into four categories:

  a) Forums and information campaigns organised by the tax administrations;
  b) Improving sources of information, including new databases of specific information concerning real estate transactions;
  c) Organizational restructuring in tax administrations e.g. establishing specialized tax teams; and
  d) Inventories of real estate properties.

In terms of performance over the last three years, most countries surveyed reported difficulties in measuring the results of their tax administration's compliance activities during the period requested. Since most of the projects are in their early stages, it is too early to give comprehensive results. However an indication of amounts at stake is the result of a nationwide project in 2006 by the Irish Revenue focusing on compliance in the construction sector. The project involved 1,615 site visits during which 1,188 unregistered individuals were identified. In addition, 3,872 audits were completed. As a result of the various actions €125million euro was recovered.

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REPORT ON TAX FRAUD AND MONEY LAUNDERING VULNERABILITIES INVOLVING THE REAL ESTATE SECTOR

I. Background:

1. During the March 2006 meeting of the Working Party No. 8 Sub-Group on Tax Crimes and Money Laundering (TCML), delegates agreed to a process that would enable timely, systematic and comprehensive examination and reporting of selected key issues and risk areas. Delegates subsequently agreed that the two areas to be examined by the Sub-Group under the new process over the next 12 months are:

- tax fraud and money laundering vulnerabilities associated with the real estate sector; and
- tax fraud and money laundering vulnerabilities associated with identity theft.

2. The Secretariat distributed questionnaires to Sub-Group delegates in July 2006 and it was agreed that the responses would be used as the basis for preparing comprehensive reports on these issues.

3. The questionnaire on the real estate sector contained three different groups of questions:

a) Questions 1 to 3 related to the extent of tax fraud and money laundering that involves the real estate sector: How widespread is this risk in each country? How many other sectors, groups, professions, industries are involved? Has the amount of tax fraud been estimated or measured?

b) Questions 4 to 9 related to detection strategies and techniques, outlining general compliance and detection strategies (including targeted education campaigns) implemented in each country.

c) Questions 10 to 12 related to investigation strategies and techniques, including tax audit activities carried out in each country, including how tax authorities work in collaboration with other law enforcement agencies.

4. This report is based on the responses to the questionnaire provided by 18 countries represented in the Sub-Group in response.[1]

II. Survey findings and observations.

5. The real estate sector in the context of this report has to be understood in a broad sense, including the different stages of the business process (i.e. land development, building construction and economic exploitation of real estate properties). This sector is often regarded as one of the largest employers in several countries with a significant size in terms of percentage of GDP. Furthermore, the real estate industry has linkages with other sectors of the economy and associated industries, which result in a multiplier effect in its capacity to generate income.

[1] The eighteen countries are: Argentina, Australia, Austria, Canada, Czech Republic, Denmark, Germany, Ireland, Japan, Mexico, The Netherlands, Norway, Portugal, Spain, Sweden, Turkey, United Kingdom, and United States.

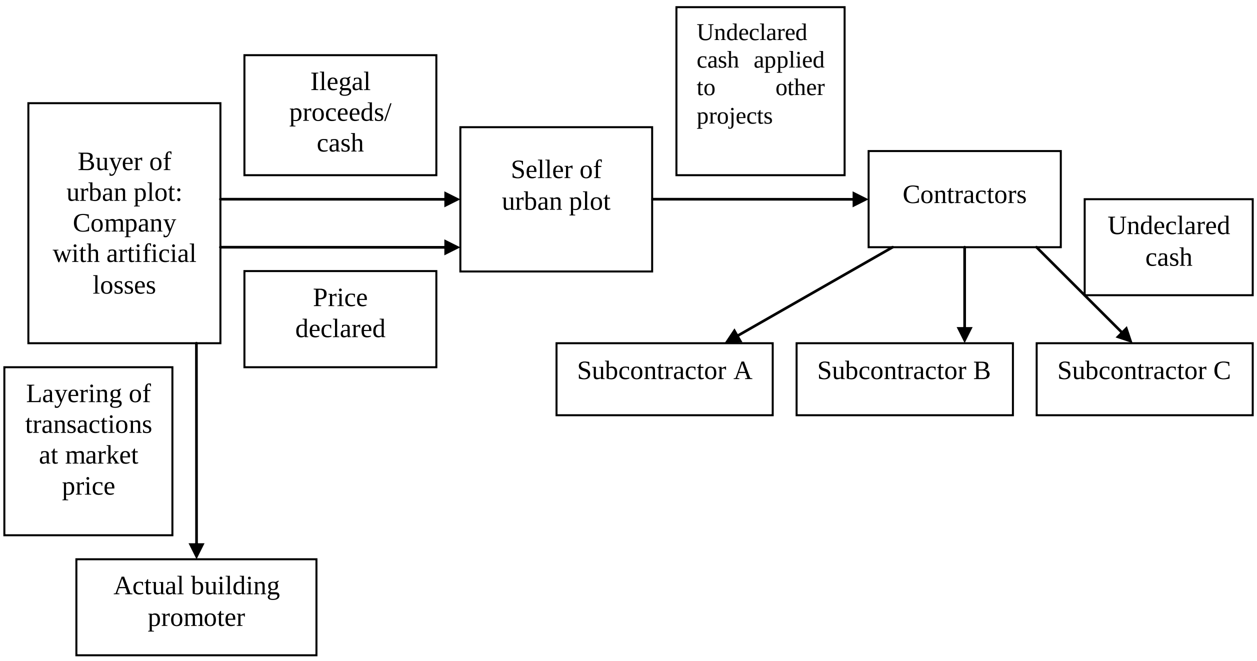
6. For the purposes of this report, money laundering in the real estate sector is defined as the process of concealing the proceeds of crime, moving value through transactions performed in this industry, in an attempt to legitimise its illegal origin.

7. The following example of price manipulation highlights the nature of tax fraud and money laundering in the real estate sector. Price manipulation in real estate transactions is one of the oldest methods of fraudulently transferring illegal proceeds between different parties, and there are tax implications in such cases. When the price has been invoiced below the actual price, the seller receives more than it declared for the transaction. This implies undeclared income for this transaction and the availability of the proceeds for subsequent under-declared transactions, which can result in a multiplier effect in terms of tax fraud. Alternatively, if the price is over-invoiced, similar schemes of tax fraud usually coexist with this means of money laundering. In the case below, undeclared works carried out by contractors may help the acquiring company to avoid unjustified losses that could trigger a tax audit and may assist it in laundering additional illegal proceeds.

EXAMPLE 1: PRICE MANIPULATION

Cash from illicit proceeds is used to acquire an urban plot to construct a block of apartments. The price agreed for the transaction is under-declared and the plot seller is a real estate developer who has other projects under construction. The undeclared cash obtained is used in the business process in a series of undeclared/under-invoiced transactions with contractors and sub-contractors.

To mitigate the tax effect of the under-valued urban plot, the company that acquires the plot creates artificial losses[2] to set-off with artificial profits derived from the transfer of the terrain. To minimize tax risks, the first purchaser of the property is typically a company owned by "straw men¨ to conceal real ownership and the layering of transaction may greatly increase the difficulty, time and expense associated with uncovering the taxpayer's scheme.



2 A large number of money laundering and tax fraud schemes require at a certain stage the use of tax avoidance schemes or of aggressive tax planning.

Quantifying the tax fraud and money laundering risks associated with the real estate sector

8. In most of the countries surveyed, the real estate sector has been identified as a sector that is used to facilitate tax fraud and money laundering. There is a general concern that the construction industry has been targeted as a means of generating unreported income and of investing unreported income coming from other industries, including illegal activities. In 2006 the Irish Revenue initiated a nationwide focus on compliance in the construction sector. The project involved 1,615 site visits during which 1,188 unregistered individuals were identified. In addition, 3,872 audits were completed. As a result of the various actions €125million euro was recovered.

9. Despite the fact that the number of property sales and property values could be estimated (in certain countries even from information stored in administrative/governmental bodies' databases) and that information available about transactions is normally higher than in other sectors, none of the countries have reported official figures or statistics. **Austria**, however, estimates that the amount of fraud involving the real estate sector is approximately € 70 million.

10. One reason that may explain this circumstance is that in most of the countries surveyed there has been a rapid increase in property acquisition and development in recent years. Increased number of transactions accompanied by escalating prices may have made it much more difficult to make estimations on the amount of fraud.

11. Since accurate estimations of tax fraud in this sector can only remain valid for short periods of time, this raises issues about whether efforts made to find out an approximate estimation of fraud would be worth it. However, since the relative weight to be given to compliance activities by tax administrations depends on the tax fraud risks associated to each economic sector, it follows that the development of methodologies that could assist the countries to effectively estimate the extent to which the real estate sector is being used to commit tax fraud could allow the countries to better allocate limited resources.

12. Many cases of money laundering and tax crimes in the real estate sector have been reported and in almost all of them there is involvement both at domestic and international level. However, quantified estimates either of tax fraud or of money being laundered through real estate transactions have not been reported and nor is there information on the types of crime that are considered to be the major sources of illegal proceeds being laundered in this sector. It assumed that abuse of the real estate sector is preferred by all types of criminal activities.[3]

Key issues in terms of tax fraud and money laundering vulnerabilities in the real estate sector

13. The table below outlines the key issues in terms of perception of vulnerabilities in the different countries. Most of the responses indicate that one of the key features regarding the vulnerabilities in this sector is that real estate properties are typically high value and high-yield investments. The three most reported vulnerabilities have been: a) that the correct value of real estate can be easily under/over declared (**Australia, Canada, Germany, Ireland, Spain, Sweden**); b) its potential attraction to criminal money (Argentina,[4] **Australia, Ireland, Spain, Sweden, United Kingdom, United States**); and c) the possibility to conceal ownership (Argentina, **Australia, Canada, Ireland, The Netherlands, Portugal**, **United Kingdom**).

3 The range of cases studies in the FATF typology report Money laundering & terrorist financing through the real estate sector indicates that real estate transactions are very attractive for laundering the proceeds of a wide range of crimes.

4 More precisely, Argentina reported difficulties in tracking origins and destinations of funds invested.

Vulnerabilities
Rapidly escalating prices of residential and business properties[5]
The correct value of real estate can be easily under/over declared
Its potential attractiveness to criminal money
The possibility to conceal ownership: - Difficulty to identify the beneficial owners of off-shores companies and/or through a complex structure of ownership - Acquisition of properties overseas - Use of nominees - High real estate turnover combined with rapidly changing hands
Payment means: - Lack of administrative access to bank information - Use of large amount of cash
The use of illegal workforce / infra-structural work
Complex layering of transactions
Intermediaries: - Misuse of Notaries - The intervention of real estate agents and other intermediaries in this sector as key facilitators of money laundering and tax fraud[6]
Leakage/evasion of Relevant Contracts Tax. [7]
Possible aggressive tax planning practices that may be designed to relieve taxes due
Corruption and/or other related crimes
Difficulty to obtain timely and reliable information on property sales and money transfers associated with the real estate sector

14. There has been a property boom in many countries over the last decade.[8] This has attracted a great deal of attention from a tax planning point of view and there is a concern that the sector has been infiltrated with monies from illegal proceeds. In this sense, the combination of high value properties with

5 In Ireland prices are around 4-5 times higher than in 1996.

6 By assisting in concealing ownership and accessing fraudulent loans through false applications.

7 In this case, the underlying vulnerability is that the value of construction works can not be easily measured

8 Prices reported by certain countries of residential and commercial properties, now several times greater than ten years ago.

the practice of allowing a number of payments by installments increases the tax and money laundering risks associated with this sector.

15. Escalating prices also make it easier to manipulate prices of properties and transactions, which makes it is more difficult to determine a single fair market price at a certain date. Directly connected with price manipulation are two of the vulnerabilities associated with payment means reported by the countries: a) Limited administrative access to bank information[9] (**Portugal**); and b) the use of large amounts of cash. But new payment methods that include stored-value cards (also known as prepaid cards) and internet payment systems were not raised as issues in the responses provided by the countries surveyed.

16. The possibility of concealing ownership is another vulnerability reported by a considerable number of countries surveyed. This vulnerability has four main variations: a) onshore acquisitions through off-shores companies and/or through a complex structure of ownership; b) unreported acquisition of properties overseas; c) use of nominees; and d) Property flipping.[10] Nominees could also be used in combination with a) or b).

17. Evasion of Relevant Contracts Tax has been reported as vulnerability by **Ireland**. This typically happens in contracts between the main contractor and the subcontractors. The underlying vulnerability is that the value of construction works cannot be easily measured. The use of low-paid, illegal workforce on infra-structural work combined with the evasion of relevant contracts between contractors and sub-contractors appears as a special threat that may hamper efforts for tax fraud detection, since in these cases a relevant part of both revenues and expenses are neither recorded nor reported for tax purposes. Further, unjustified losses and discrepancies that may result from the failure to declare revenues from relevant contracts and that may trigger a tax audit, are avoided by under-declaring the costs that represent illegal workforce which may assist in laundering additional illegal proceeds.

18. In this context, joint-agency investigations, especially in co-operation with Labour enforcement authorities targeting the wilful failure to declare relevant contracts, seem to be efficient strategies to fight against such methods of money laundering and tax fraud.

19. Notaries and other intermediaries should play an important role in deterring and detecting money laundering and tax fraud[11]. However, the misuse of such intermediaries can result in schemes of fraud more difficult to detect and investigate.

20. Difficulty to obtain timely and reliable information has been reported by **Australia**. In some countries, tax authorities have access to information available in land registry records/official registers. Several countries also reported access to suspicious transaction reports and/or financial transaction reports provided by other government departments. In **Sweden**, tax authorities receive automatic information from all transactions concerning real estate.

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9 This is not just a vulnerability specific to the real estate sector; it affects other industries as well.

10 Comment sent by The Netherlands. Property flipping: chain of buying and selling where the value of the real estate increases in a short period of time and where the identity of the real contracting parties is unclear (so-called ABC transactions). A facilitator might also be involved in such a scheme.

11 According to FATF's recommendation number 16, notaries should be required to suspicious reporting obligations when on behalf of a client they engage in a financial transaction in relation to the activities described in recommendation number 12, which includes among other: buying and selling of real estate properties. According to FATF's recommendation number 12, the customer due diligence and record-keeping requirements apply to a list of designated intermediaries that includes real estate agents.

Methods and schemes used to commit tax fraud and money laundering in the real estate sector.

21. Some of the countries surveyed reported that criminal proceeds have been used in the real estate sector, either as investments or by direct/indirect involvement in the construction business. **Australia** notes potentially less complexity involved in real estate investments to launder funds than other money laundering schemes.

22. The countries surveyed reported the following most common methods and schemes used to commit tax fraud and money laundering in the real estate sector:

> Price manipulation: **Australia**, **Canada, Denmark, Ireland, Mexico, the Netherlands, Portugal**, the **United Kingdom** and the **United States**.
>
> – Undeclared income /transactions: **Australia**, **Canada, Ireland, Mexico, Norway** and **Portugal**.
> – Fictitious transactions: **Canada and the Netherlands**
> – False invoicing: **Australia**, **Mexico, Norway** and **Portugal**.
> – The use of illegal workforce / infrastructural work: **Norway**.
> – Layering of transactions: **Canada, Ireland, the Netherlands**.
> – Use of nominees and/or false identities, corporations or trusts to hide or disguise ownership onshore and/or offshore**: Canada, Denmark, Ireland, Mexico, the Netherlands, Norway, Sweden, the United Kingdom** and the **United States**.
> – Use of short-lived companies: **Norway**, **Mexico**.
> – Aggressive tax planning: **Australia,**[12] **Mexico**.

23. Fictitious transactions are a common method to commit money laundering and tax fraud in the real estate sector. Sometimes it simply involves false invoicing, but in many cases other false documents are required. Due to the rules that apply to the transfer of immovable property and ownership rights of real estate,[13] the most commonly affected transactions include:

a. Services rendered in the real estate sector; and

b. Financial instruments.

24. Fictitious transactions based on a financial instrument may adopt forms similar to bonds, such as debentures, used in transactions to allow an individual to convert that interest into another form of security such as a share of stock. Through the use of fictitious bonds or debentures, substantial capital gains obtained in the real estate sector can be offset with artificial losses.

25. Foreign property purchases and complex company and trust companies involving other jurisdictions have been reported by a considerable number of countries. In **Ireland**, the Criminal Asset Bureau recently stated that Irish drug traffickers were transporting their cash out of the country and investing it in offshore properties, often in the name of third parties. Conversely, foreign investors purchasing domestic properties have also been identified in the responses provided by a significant number of countries as a method for money laundering and tax fraud. One of the key components in these

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12 In response to the question about key issues in terms of vulnerabilities, Australia included aggressive tax planning among the practices that may be designed to relieve taxes due.

13 Property transfers require the buyer and seller to sign a deed before a notary which must be registered to ascertain the current property at the relevant Land Registry.

acquisitions is the use of an estate agent and/or property lawyer. Other professionals are often involved either in setting up the corporate structures used in the acquisition or in organising the back to back loan facilities to disguise the property.

26. Methods linked to financial instruments and institutions and intermediaries have been reported by **Canada** (property flips and loans), the **United Kingdom** (back to back loans); The Netherlands (back to back loans); and the **United States** (property flipping, two sets of settlement papers and fraudulent qualifications).

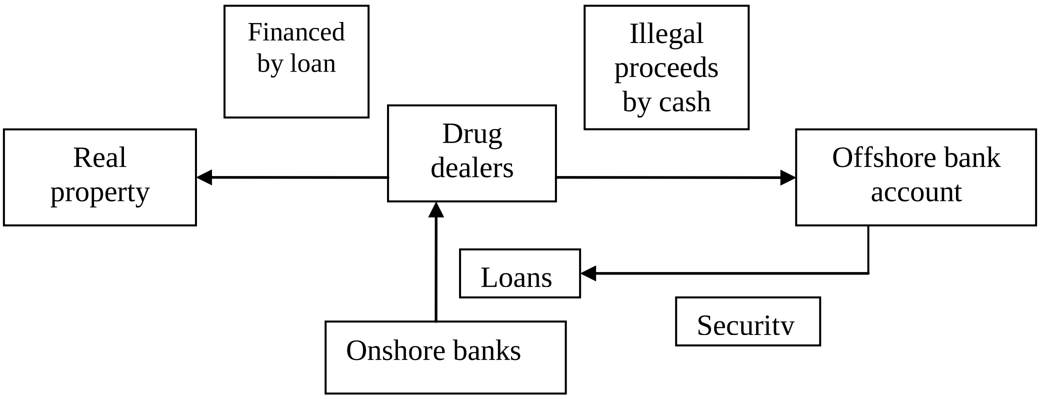
EXAMPLE 2: Back-to-back loans with illegal proceeds in real estate transactions.

Cash from narcotics trafficking is deposited in a bank account, which the drug dealer has opened in a tax haven using the transfer mechanisms shown in the chart below.

To finance the acquisition of real estate, a loan is made by a foreign bank through its correspondent in the country in which the acquisition is being made. The loan is guaranteed by deposits abroad. The foreign bank is then seen as the apparent lender, whereas the borrower is in fact borrowing from himself.

This technique enables the drug dealer to use his funds but under the guise of a loan. The drug dealer deducts from his income the interest on the loan that has been granted to him, thus creating a fictitious expense.[14]

Chart:



Detection strategies and techniques

27. There is no single technique or strategy typically employed to identify taxpayers that use the real estate sector to commit tax fraud and money laundering. Traditional techniques based on risk analysis, risk profiling and data matching coexist with other more advanced and contemporary tools such as statistical analysis and data mining.

14 In addition, this transaction allows the drug trafficker to amass a second reserve of funds abroad, equal to the amount borrowed, which in many cases is paid back in a lump sum at the term of the loan—and it allows him to do so in all apparent legality.

28. The following table shows the main detection techniques reported by the countries surveyed.

Detection strategies and techniques	Country
Risk analysis/Risk profiling	**Argentina**: Based on the data gathered, along with other variables that define the degree of taxpayer compliance, a matrix is defined to enable the tax administration to classify taxpayers by categories according to their tax risk profile. **Canada:** The CRA's risk assessment systems use information from internal and external sources including provincial property assessment and sales tax data. They can also be used to analyze potential non-compliance by industry sector or geographic region, thereby facilitating the strategic targeting of enforcement efforts. The CRA also uses information received from treaty partners, informants and law enforcement agencies in audit selection. **Germany:** Purchase of real property at unusual conditions / under unusual circumstances **Ireland:** Risk evaluation, analysis and profiling system has been put in place this year which gathers centrally all intelligence information in Revenue to help target those who are likely to be involved in tax fraud or money laundering. **Norway:** The tax authorities follow closely all the largest construction projects in the country. The tax authorities examine all contracts, subcontractors, the workers etc. **Spain**: (ZUJAR) computerized taxpayer selection tool which categorises the information available according to predetermined factors.
Data matching	**Portugal**, **United Kingdom**, **and United States:** Match/cross check taxpayer's information for case selection. **The Netherlands:** Data matching techniques confronting public registries information against private registries and tax files
Data mining	**Germany**: Data mining pilot project. **The Netherlands**: data mining with information of public registries. **Sweden:** Data mining techniques not specifically designed for real estate sector.
Statistical analysis	**Denmark:** To detect non declared real estate properties owned by Danish taxpayers abroad. **Mexico:** Taxpayer's statistical distribution in terms of profitability and debit/credit ratio.
Other	**Germany:** Training programs for tax examiners to develop skills in detecting money laundering and tax fraud.

29. Data matching is one of the most common and traditional techniques, however the use of electronic tools to analyze tax and other records has greatly expanded possibilities over the last decade. This technique requires the availability of comprehensive information coming from different sources and

in most of the countries that use this technique, information provided by suspicious transaction reports is crucial.[15] In **Ireland,** the Irish Revenue Office directly receives suspicious transaction reports from auctioneers and estate agents and is directly involved with their representative bodies to assist in educating them so that they are able to better identify the use of tax evasion techniques. In the **United Kingdom,** the analysis of Suspicious Activity Reports also provides essential information for case selection. In the **United States,** the IRS uses two primary strategies for case selection.

30. In the **United States,** the IRS uses two primary strategies for case selection. The first strategy is to require real estate agents to file four forms with the IRS relating to real estate transactions in the United States. These forms can then by analyzed by computers against tax and other records to identify possible fraud schemes. The four forms are:

- Form 1099-S (filed for every real estate transaction conducted in the US involving a US citizen or resident);

- Form 8288-A (which is a statement of how much federal taxes were withheld from income associated with the sale of real property in the US. filed when the real property is sold by a "foreign person");

- Form 8288-B (which is an application to reduce or eliminate federal withholding taxes associated with the sale of real property in the US by a "foreign person", filed when the real property is sold by a "foreign person"); and

- Form 8300 (Currency Transaction Report, filed if more than $10,000 in cash or equivalent financial instruments, such as money orders, bank drafts, traveller checks, etc. are received for the purchase of real estate).

31. Form 1099-S documents are compared by computers against the tax return of the seller filed for the year the transaction occurred to verify if the transaction is recorded on the tax return. Form 8300 documents are analyzed for suspicious tendencies, i.e. significant amount of cash received, multiple cash transactions to purchase property, etc., to identify possible real estate fraud, particularly real estate being purchased with illegal proceeds.

32. The second strategy implemented in the **United States** is focussed on real estate fraud specialities. There is a real estate project team whose purpose is to identify property sales that have high risks in terms of money laundering and tax fraud. The coordinator of this project has access to Land Registries' databases and the relevant information collected from these databases is matched against IRS's databases.

33. Countries that have reported the use of risk analysis techniques also report the relevance of analysing internal and external sources of information by computerized tools which categorise the information available according to predetermined factors (e.g. profiling).

34. The relevance of training programs for tax examiners to develop skills to detect money laundering and tax fraud has been reported by **Germany**. Extensive training courses have proven to be effective in improving detection of such cases.

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15 International exchange of information will be dealt with in this report under "**Automatic exchange of information between tax authorities**".

35. Despite the growing use of the internet to advertise real estate properties on the market, none of the countries reported the use of electronic tools[16] to search it as a technique to detect suspicious transactions.

Level of success of strategies and techniques used in detecting suspected cases of tax fraud and money laundering in the real estate sector

36. Since the totality of the problem is often unknown, even in those countries with a systematic approach to identifying and detecting suspected cases of money laundering and tax fraud in the real estate sector, there is not always an evaluation of the results achieved.

37. Some countries reported that during the past few years, the number of cases being investigated has been increasing steadily as a consequence of the results obtained in the previous years. In **Ireland,** over 1300 owners of offshore properties have been identified and these cases are being reviewed to identify any cases of tax fraud and/or money laundering. **Mexico** reports an effectiveness of 91% in finding tax irregularities. In the **United States,** during the past 5 years, the number of cases being investigated has been increasing steadily. In 2001, IRS-CI opened 107 investigations. In the current year, IRS-CI has opened 246 investigations in the first 9 months.

38. Planning corruption[17] has been identified in several countries (**Ireland**, **Portugal** and **Spain** among others) as an issue, but none of them have reported comprehensive strategies to tackle this problem. In **Ireland,** the Planning Tribunal has been particularly effective in counteracting this problem, as it has the authority of a High Court. **Ireland** reported that a number of high profile politicians and business persons have been charged with tax offences or corruption, some serving jail sentences as a result of this process. A robust zoning regulation plus effective access and exchange of relevant information are key factors for any preventive strategy concerning this emerging issue. Additionally, because the extent to which the value of land increases when rezoning, it has been reported by **Ireland** that special vigilance of the beneficiaries of these decisions is carried out to ensure that there are no complex arrangements that might suggest impropriety.

"Red flag indicators" that are used by the country's tax administration for detection purposes

39. In almost all the countries surveyed, certain types of transactions serve as indicators that call for case selection and/or for further scrutiny in the process of tax audits. A list of red flag indicators is effective when:

a. It is adaptable to the changing environment; and

b. All the personnel involved in tax compliance issues are aware of its existence.

40. A comprehensive list of red flag indicators has been provided by the countries and a large number of them concern payment means. There is also a significant number of indicators related to certain attitudes observed when collecting information from third parties (especially from intermediaries such as real estate agents) and when auditing taxpayers whose transactions have not been conducted in the usual course of business.

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16 Such as meta-searchers and web robots.

17 Planning is a concept used to identify activities dealing with the design and organisation of urban spaces. Typically these activities are carried out by local governments. The simplest case of planning corruption involves bribes paid to local officials for unjustified changes in the designated uses (residential use, commercial use, etc.) of specific areas.

41. The following are the most common red flag indicators reported by the countries surveyed. These indicators are outlined below in four (4) categories.

a. Data discrepancies:
   - There are discrepancies in apparent wealth and reported incomes.
   - Rent paid is low given value/cost of property.
b. Individual characteristics, Identity, Behaviour, and Association
   - Purchaser does not want to put his or her name on any document that would connect him or her with the property or uses different names on Offers to Purchase.
   - Purchaser inadequately explains the last minute substitution of the purchasing party's name.
   - Purchaser buys multiple properties in a short time period, and seems to have few concerns about the location, condition and anticipated repair costs of each property.
   - Atypical behaviour when compared to similar taxpayers (activity and size).
   - Economical operator with low or negative profits and high cost rates of subcontracting.
   - Where a person is seeking to purchase real estate in the name of a nominee and has no apparent legitimate explanation for the use of a nominee.
   - Where a person is acting, or appears to be acting, as an agent for an undisclosed party and is reluctant or unwilling to provide information about the party or the reason for the agency relationship.
   - Under age purchaser
   - Where a person does not appear to be sufficiently knowledgeable about the purpose or use of the real estate being purchased.
   - Attempts to bribe (lenders, realtors, appraisers etc.).
   - Transactions surrounded by secrecy and not conducted in the usual course of business (closing/settlement held after hours, creative financing, and exchange of currency at closing).
   - Inconsistency between value of properties acquired and reported wealth and/or income
c. Financial analysis:
   - Use of significant amount of cash to purchase or rent real estate properties, sometimes in combination with unusual advanced payments.
   - Client is known to have paid large remodelling or home improvement invoices with cash, on a property for which property management services are provided
   - Real-estate loans above or equal to the building acquisition value.
   - Evidence of the appeal of frequent partners loans of considerable amounts.
   - Where a prospective buyer is paying for real estate with funds from a high risk country, such as a ‘‘non-cooperative country or territory’.[18]

[18] It also could be included under Individual characteristics, Identity, Behaviour, and Association.

- Where the seller requests that the proceeds of a sale of real estate be sent to a high risk country.[19]
- Predatory Lending Practices.

d. Documentation and business operation:

- Where the person provides suspicious documentation to verify his or her identity.
- Where the prospective purchaser or seller seeks to have the documents reflect something other than the true nature of the transaction.
- Layered Transactions.
- Double Set of Books/Settlement Statements.
- Destruction of Books and Records.

Cases that involve the use of the real estate sector to commit tax fraud and/or money laundering

42. The real estate sector involves a wide range of activities with different characteristics. For this reason, the activities have been classified into three different groups:

a) during the terrain development;

b) during the building process; and

c) after the construction is finished.

43. In some countries, the distinction between different phases of the construction process does not seem to be relevant. This is the case in **Australia** and **Ireland**. In **Australia**, most of the cases detected deal with fictitious payments (supported by false invoicing and/or payments to fictitious persons). In **Ireland,** the areas of concern, regardless of the stage of the business process, are:

a) the use of foreign nationals by construction companies (sometimes also used to misdirect funds to conceal profits);

b) false invoicing by subcontractors; and

c) potential beneficiaries of land value increases when new areas are rezoned.

44. Although the distinction between different phases of the construction process does not seem to be relevant in **Australia,** the reported cases of insolvency law involving property developers seeking to avoid tax payments obligations are only connected with the terrain development. Similarly, in **Ireland,** potential beneficiaries of land value increases mainly involve the rezoning process.

45. The distinction between different phases of the construction process cannot ignore the links between cases detected across the different stages outlined above. Cases of planning corruption have been identified in several countries, but it is useful to note that the proceeds to commit this sort of crime come not only from illegal activities but also from undeclared profits obtained in other transactions of different stages of the real estate industry. A good understanding of transmission mechanisms of money laundering and tax fraud across different phases of the business processes is essential to assist in the identification of

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19 It also could be included under Individual characteristics, Identity, Behaviour, and Association.

suspicious cases and represents one key factor when designing strategies to tackle the problems detected in this sector. In **Argentina,** the tax administration conducts broad audits in the real estate construction sector, not only covering a specific taxpayer but also the supply chain of goods and services involved in the previous and following stages of the taxpayer's business. This approach appears to be effective, especially when a large-scale tax fraud is detected. This strategy requires the availability of information sources that link such transactions and effectively coordinated audit teams.

46. In countries where the distinction among different stages is apparently more relevant, cases of false invoicing (sometimes in combination with shell entities or letter-box companies with or without bank account(s) in other jurisdictions) have been reported involving the terrain development and the building process stages.

47. During the building process, short-life companies represent another type of case reported by the surveyed countries. The way in which these companies can be used to commit money laundering and/or tax fraud are:

a) by issuing false invoices that are used by the recipient to deduct fictitious expenses and/or indirect taxes; and

b) under schemes of insolvency to avoid tax payment obligations, with or without straw-men or any other means to conceal ownership.

48. Concealed ownership is usually presented in many cases of tax fraud and/or money laundering during the terrain development and the building process. However, none of the countries in which bearer shares or bearer debts are permitted have been reported as a concern. This may be at least partially explained by the fact that in those countries where such instruments are permitted, such instruments do not preclude the identification of owners where appropriate mechanisms are in place.

49. Among the member states of the European Union (EU), only **Denmark** and **Portugal**[20] reported works carried out by foreign companies as one of the cases of tax fraud detected during the building process. Within the EU, Directive 96/71 EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services allows, to post workers to the territory of another Member State. These provisions which are intended to prevent 'social dumping' of companies shipping low-cost workers into high-cost economies in order to save money should not result in new opportunities for tax fraud and money laundering. A number of competent authorities of EU Member States have signed agreements on automatic information exchange that cover in particular income from dependent personal services, which should assist in identifying potential tax fraud.

50. The use of foreign nationals by domestic construction companies is another case reported by **Ireland**. The huge increase of foreign nationals coming to developed economies has resulted in many cases of illegal workers employed in construction activities which could have assisted in the laundering of illegal proceeds by undeclared payments and opening new opportunities to commit tax fraud. There is also anecdotal evidence from suspicious transaction reports that some employers are using these foreign nationals to misdirect funds to conceal profits.

51. After the construction is finished, undeclared income from high value properties and/or under-declared rents seem to be the most common cases detected by the countries. Due to the rules that apply to the transfer of immovable property, which require in most of the surveyed countries that the buyer and seller sign a deed before a notary which must be registered at the relevant Land Registry, undeclared sales

20 Outside the European Union, **Norway** reported detection of this type of case.

in this stage of the business process seem to represent a lower risk[21] than in other phases and such cases have only been reported by **Denmark** and **Norway**.

Automatic exchange of tax information between tax authorities

52. Automatic exchange of information (also called routine exchange by some countries) involves the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (e.g. dividends, interest, royalties, salaries, pensions, and also real estate transactions).Table A in Annex 2: "*Automatic exchange of information on the real estate sector between tax authorities*", contains four (4) different groups of information: purchaser information, vendor information, property information and transaction information.

53. This type of automatic exchange is rather new and there is no strict reciprocity as some countries receive information automatically on real estate transactions but are not yet able to provide any. For instance, **Canada** has been receiving real property information annually from **France**, **New Zealand** and the **United Kingdom**, either as paper records or in a spreadsheet, at least since 2003. **Norway** has automatically received information from **Sweden** concerning real estate transactions in the fiscal years of 2003 and 2004.

54. There are difficulties in exchanging data on real property transactions. These difficulties may be due to the availability of the information to the tax authorities, the ability to capture the data if the information is available, the ability domestically to extract the relevant information for treaty partners and the inability to report the data in the existing OECD SMF fields or STF schemas.

55. Regarding purchaser information, some countries have different types of information available to exchange and there is not yet any standard format to exchange automatically information on real estate transactions.

56. Purchasers' tax identification numbers (TINs)[22] are not available in **Australia**, **Japan**, and the **United Kingdom**.[23] Tax identification numbers are useful for processing information received automatically from treaty partners. In the absence of a TIN matching is done based on the name and address of the taxpayer.

57. At this time, the US is not automatically sending any tax information to its treaty partners concerning the sale of real estate. However, it is considering providing Form 8288-A to treaty partners as part of its automatic exchange of information programme. Form 8288-A is a Statement of Withholding on Dispositions by Foreign Persons on US Real Property Interests. Form 8288-A reflects tax withheld by the buyer on dispositions by non resident persons of real property interests.

58. In relation to vendor information, **Argentina**, **Norway**, **Portugal**, the **United Kingdom** and the **United States**, information on other vendors, other purchasers and addresses is available but only automatically exchanged by **Argentina** and **United Kingdom.**

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21 Note that in countries like **Sweden**, the Tax Administration receives automatically information concerning all purchases and sales of real estate properties.

22 In 1997 the OECD Council adopted a recommendation on the use of tax identification numbers (TINs) in the international context. (C(1997)39/FINAL).

23 The United Kingdom reported that it does not have a TIN.

59. All the countries reporting automatic exchange of information on real estate transactions use an identifier[24] of properties transferred. In **Norway** and **Spain**, there is an identification number attributed to properties which is permanent.

60. As far as transactional information is concerned, information on the means of payment for real estate has been reported as being available in **Canada,** but is limited to:

a) whether there was a payment or security;

b) date of the transaction; and

c) and amount paid/received for property available to tax authorities.

61. With the exception of **Australia**, information on the date of the transaction and the amount paid/received for the property is available in all the countries that have responded to this part of the questionnaire.

62. The **Argentinean Tax Administration** is a signatory to three cooperation agreements with institutions that play a role in automatic exchange of information activities: a) testate Agency of Tax Administration (AEAT); b) the National Tax Administration Superintendence of Peru (SUNAT); and c) the Federal Revenue Secretariat (SRF) of Brazil.

63. **Ireland** has been participating in automatic exchange of information on real estate with **France** and the **United Kingdom** since 2002.

64. Since 2002, **Norway** has been receiving automatically paper-based real estate transaction information from **France**. This type of information will soon be transmitted by France in a digital format and will therefore be easier to process. Paper-based reports can be processed as they are or digitalised to be entered into the recipient country's tax data base and automatically matched against the income and capital reported by the taxpayer.

65. Over the last 5 years, the **United Kingdom** has automatically exchanged information (including information on real estate transactions to Australia; Austria; Belgium; Canada; Cyprus; Czech Republic; Denmark, Estonia; Falkland Islands, Finland, France, Germany, Greece, Guernsey, Hungary, Iceland, Ireland; Isle of Man; Italy; Japan; Korea; Latvia; Luxembourg; Malta; Netherlands; New Zealand; Norway; Poland; Portugal; Russian Federation; Slovenia; South Africa; Spain; Sweden; Trinidad & Tobago; Turkey and the United States. However, information is not necessarily provided to each country every year, and there are no statistics to show how many of these exchanges relate to real estate transactions.

66. In **Canada**, a new program called the Non-Resident & Emigrant Dispositions Database (NEDD) is under development and is expected to be operational nationally in 2007. **Canada** plans to exchange information contained in this database with treaty partners. This will concern purchaser and vendor information as well as property information, amounts and dates of disposition.

Information sources available to tax authorities that are used to detect and investigate possible cases of tax fraud and money laundering involving the real estate sector

67. The main information sources available reported by the countries can be classified into three different groups.[25]

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24 An identifier is something that can assist to designate a specific property.

a) Reports provided by third parties, including suspicious transaction reports and cash transactions reports, particularly those filed by real estate agents and financial institutions.

b) Tax returns filed by taxpayers with real estate information that can be matched against the other records provided by third parties (real estate agents, financial institutions, etc.).

c) Public Office records, including Land Registries/State Land Title Offices and notaries.

68. According to the responses provided by the countries to the questionnaires, the tax authorities in **Australia**, **Canada**, **Denmark, Ireland, Norway Portugal, Spain,** the **United Kingdom** and the **United States** have access to suspicious transaction reports and/or financial transaction reports provided by other government departments.

69. In **Argentina,** reports from third parties include information provided by agents of non-resident taxpayers on real estate transactions (such as real estate transactions and rentals) performed on behalf of non-resident taxpayers. Should these transactions be performed by non-registered agents, they must act in the capacity of information agents for the third parties involved.

70. Regarding tax authorities' databases, in **Ireland** a database is being populated of property agents involved in selling property offshore. In the **United Kingdom**, tax authorities have access to other Government Departments' databases (OGD). There are also MOUs with other domestic organizations and overseas agencies, including fiscal authorities and police.

71. Most of the countries reported that the sources of information available include land registry records and official registers. In **Ireland,** Land Registries provide tax officials with on-line access and search facilities to analyze this information (access to similar registries is also reported by **Argentina, Australia, Austria, Denmark, Germany, Mexico,** the **Netherlands, Norway, Portugal** and **Spain**).

72. **Sweden** reported that it is not possible to buy and sell real estate in Sweden without the knowledge of the tax authority. However, since the price, means of payment and the parties involved can be fraudulently manipulated, this information on its own cannot be considered sufficient to detect and investigate money laundering and tax fraud in the real estate sector. **Sweden** also reported that the information mentioned in Table A is automatically available to the tax authority and is used in the audits of tax returns regarding the selling of properties.

Methods and strategies used by tax authorities (including multi-agency cooperation) to investigate tax fraud and money laundering in the real estate sector

73. Traditional investigations methods have been reported by almost all the countries surveyed, but these techniques vary from country to country. The most common investigation methods reported by the countries can be classified into four different categories:

a) Targeted and random audits;

b) Fraud investigations; and

c) Multi-agency operations.

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25 Information provided by treaty partners has not been reported by any of the countries surveyed.

74. Targeted and random audits are traditional investigative methods that have been reported by most of the countries surveyed. Both methods are typically used in all sectors for tax audit purposes. Random audits means that a taxpayer may be selected for an audit without any particular reason. Targeted audit is the result of using risk analysis techniques and/or data matching for case selection, and the main purpose of these audits is to find out the reasons for the inconsistencies detected when the case was selected.

75. Tax audits with broad scope or full audits are part of the strategy implemented by **the Netherlands**. All levels of the Dutch Tax administration are involved in these audits, and the project has been designed under a short term/long term approach. A large number of cases selected for tax audit purposes are the result of risk analysis and correspond to the typology of property flipping (around 350) and suspicious facilitators.

76. Tax fraud investigations may include the use of special investigative techniques such as undercover operations, use of informants and mail covers.

77. Multi-agency co-operation has been reported as an important strategy for detecting and investigating tax fraud and money laundering in the real estate sector. Several countries reported that their tax authority investigates cases of money laundering in the real estate sector in partnership with other law enforcement agencies. In **Denmark,** the police are in charge of these investigations in close cooperation with the tax authority. In **Canada,** the tax authority does not investigate money laundering offences but some tax authority staff are seconded to Integrated Proceeds of Crime (IPOC) units that investigate such offences. **The Netherlands** has reported agreements with financial supervisors, police, public prosecutor and local authorities (municipality). This co-operation includes the development of 'red flag indicators' in association with the police, financial supervisors, public prosecutors and municipalities.

78. In some cases, parallel investigations for tax fraud and money laundering may be pursued. In **Sweden,** the tax authority has no authority to combat money laundering on its own and the strategy is to a large extent to cooperate with other agencies. In **Portugal,** joint action between the tax authority and criminal investigation authorities to identify subcontractors are carried out. In the **United States,** for money laundering investigations, IRS-CI works with other law enforcement agencies that have jurisdiction over the predicate crime. These agencies include the FBI, the Drug Enforcement Administration (DEA), the, Department of Housing and Urban Development (HUD) and the United States Postal Service.

79. How information flows is an essential aspect of multi-agency co-operation. In **Argentina** and **Mexico**, the national tax administration and the local tax administrations share sensitive information for the purpose of detecting potential tax fraud cases in the real estate sector. In **Mexico**, strategic-level information can also be exchanged with other law enforcement agencies.

Strategies implemented by tax authorities to promote tax compliance

80. Strategies that have been implemented by the tax authorities surveyed can be classified into four (4) categories:

a) Forums and information campaigns organised by the tax offices;

b) Improvement of sources of information, including new databases populated by specific information concerning real estate transactions;

c) Restructuring of tax offices; and

d) Inventory of real property.

81. Forums and information campaigns organised by tax authorities include a wide range of strategies, from visits to educate taxpayers on the need to comply, cooperative relationships with industry

associations, publishing bulletins containing tax alerts on common compliance and interpretive topics, and disclosing abusive schemes.

82. Media and other awareness campaigns have been reported by **Denmark**, **Ireland**, **Norway**, **Portugal**, **Sweden** and the **United Kingdom.**

83. Specific tax databases containing real estate sector information are being developed and populated by tax authorities in several countries. In **Argentina,** the creation of the Risk Profile System has enabled improved tax compliance in all sectors. In **Ireland**, a database is currently being populated of property agents involved in selling property offshore. **Ireland** is also reviewing certain service providers as a source of information to identify owners of second properties. **Denmark** has started developing an inventory of real property. In **Spain**, a strategy is being developed in co-operation with the Cadastral Department and Notaries as a result of the National Tax Fraud Prevention Plan. This plan establishes the requirement to include the assigned number to each real estate property in every transfer deed executed before a notary.

84. Some tax authorities have established special teams to deal with large cases involving real estate. Such teams can facilitate and foster a greater degree of compliance by providing better service to the public and having more timely control mechanisms to effectively punish those that are not complying with the relevant laws.

85. An inventory of real estate properties is being made in **Denmark**. In **Norway** and **Spain**, there is a unique identification number of each real estate property, independent of changes of ownership and addresses. The existence of such a number provides new opportunities for tax compliance activities and exchange of information between tax treaty partners.

Results of compliance activities over the last three years

86. Most countries surveyed reported difficulties in measuring the results of their tax administration's compliance activities during the period requested. **Denmark** reports few results so far but with a perception of increasing real estate income reported and decreasing non-compliance. The perception of improving results is shared by **Argentina**, **Mexico** and **Portugal**. In **Ireland,** a recent record €22 million was paid by one company, but it is too early to give comprehensive results on the special project currently underway on the construction industry. Its very existence has increased compliance awareness in the sector. **Norway** reported an increase in real estate income reported of NOK510 million, additional tax assessed and recovered NOK 230 million (income tax), and NOK 240 million V.A.T. The following table shows statistics for the United States IRS-CI for the past four (4) years involving real estate fraud, including the number of successful prosecutions in the United States.[26]

Statistical Information*	FY 02	FY 03	FY 04	FY 05	FY 06 (6/30/06)
Case Initiations	166	215	194	235	246
Prosecution Recommendations	83	117	148	167	136

26 How to interpret Criminal Investigation data**:** Since actions on a specific investigation may cross fiscal years, the data shown in cases initiated may not always represent the same universe of cases shown in other actions within the same fiscal year. Therefore, in fiscal year 2004, the data should reflect an increase in convictions and sentenced due to the fiscal year 2003 increase in case initiations, prosecution recommendations and indictments.

Indictment/Information Filed	71	94	102	127	119
Convictions	57	81	89	91	106
Sentenced	64	65	78	78	65
Incarceration Rate	82.8%	87.7%	92.3%	89.7%	93.9%
Average Months to Serve	27	46	41	45	54