OPERATIONAL ALERT

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Laundering the proceeds of tax evasion in real estate

Issued in partnership with the Canada Revenue Agency

Purpose

The purpose of this Operational Alert is to support reporting entities in recognizing financial transactions in the real estate sector suspected of being related to laundering the proceeds of tax evasion.

This Operational Alert is issued by the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) in partnership with the Canada Revenue Agency (CRA). Its purpose is to provide a set of contextual risk indicators relating to non-compliance with tax laws in the real estate sector, which includes tax evasion, in order to assist Canadian reporting entities in identifying the potential laundering of tax evasion proceeds through the financial system. By enhancing the identification of suspicious transactions linked to real estate-related tax evasion, Canada will be better equipped to address inherent tax evasion and money laundering vulnerabilities, to ensure that Canadians benefit from a strong and stable real estate sector.

Background

As of July 12, 2010, tax evasion is a designated offence under the *Income Tax Act* and *Excise Tax Act*. Tax evasion is defined as the intentional non-compliance with Canada's tax laws through actions such as falsifying or altering records and claims, omitting to enter material in a record book of accounts, hiding income, or inflating expenses. Since the funds generated from tax evasion are considered proceeds of crime, tax evasion and money laundering frequently intersect, as criminals employ money laundering mechanisms and techniques to conceal the true source of funds. Additionally, the funds used to invest in real estate may themselves be proceeds obtained from other crimes—such as drug trafficking and human trafficking—and are also subject to taxation[1]. As a result, money laundering techniques used to hide taxable income are often the same techniques used to launder proceeds from other types of crime.

Canada's real estate sector is used by criminals to facilitate tax evasion and money laundering. "Real estate" sector in this report refers to the sector in a broad sense and includes the various stages of the real estate process such as land development, building/construction of the property and the sale of properties. Professionals in the real estate sector can wittingly or unwittingly facilitate tax evasion and money laundering methods.

According to Canada's [Updated Assessment of Inherent Risks of Money Laundering and Terrorist Financing], Canadian real estate is considered to be attractive both as a destination for laundered funds and as a channel to launder the proceeds of crime. Furthermore, money laundering through real estate can include elements such as an influx of foreign capital from politically exposed persons, the use of underground banking networks as well as opaque ownership structures aimed at concealing the beneficial ownership.

[1] According to the [Canada Revenue Agency], all persons earning income must declare it, regardless of its source.

Tax evasion through the real estate sector is commonly facilitated by the ability to easily manipulate the price of a given property, and the ability to use nominees, false identities, corporations or trusts to hide the identity of the ultimate beneficial owners[2]. Real estate can also be used to generate income that goes unreported to the CRA, particularly from capital gains made from buying and reselling property within a short period for a profit ("flipping"), from the sale of a property that is not the taxpayer's principal residence or when non-residents do not report the capital gains from properties that they acquired and sold in Canada as a business endeavour. Tax evasion can also originate from unreported and unremitted income tax and/or Goods and Services Tax/Harmonized Sales Tax (GST/HST) collected from the sale of new or substantially renovated properties.

Overview of money laundering and tax evasion in the real estate sector

Tax evasion in the real estate sector can take different forms. This Operational Alert focuses on some of the most common and important methods. One such method involves financing the purchase of property outside a financial institution with no logical explanation provided. This is often done by relying on a private lender or unlicensed money services business. Tax evasion in the real estate sector can also be identified by the flow of funds through often unsuspecting mortgage brokers and/or immigration consultants, along with the use of trust accounts—particularly those in tax havens—for the purpose of purchasing a property but without securing a mortgage or establishing interest payments.

Other types of illegal activities such as mortgage fraud, identity fraud, terrorist

Tax evasion methods in the real estate sector

In addition to the potential exploitation of the real estate sector to launder the proceeds of tax evasion, certain activities are undertaken by actors within the real estate sector that may lead to the generation of criminal proceeds through tax evasion.

Exploiting assignment contracts

One common way for developers and/or builders to evade taxes in the real estate sector is by exploiting assignment contracts, which involves the property being sold multiple times to different buyers and/or investors before being built. Developers and/or builders can generate an unreported income on the forfeited deposit paid by buyers who cancelled their contract, on the penalty buyers have to pay for cancelling it, and on the profit made by reselling the property to another buyer at a higher price. One indication that assignment contracts are being exploited is the lack of GST/HST payments made to the CRA through disbursements from the bank account when multiple deposits for assignment fees are being deposited into the account. Assignment contracts are most commonly attached to condominiums sold to foreign buyers and transactions are frequently conducted in cash or with bank drafts. Furthermore, contracts attached to the sale of townhouses can lead to significantly higher forfeited deposits, penalties, and capital gains.

Shadow flipping

Similarly, shadow flipping is a practice in which investors or a real estate broker or sales representative can earn unreported financial gains. This is done by investors using an "assignment clause", allowing the buyer to transfer or sell their interest in the property before the closing date. Shadow flipping allows real estate brokers and sales representatives to earn multiple unreported commissions on the sale of a property and/or investors to generate unreported capital gains. Land titles obscure the use of assignment clauses or shadow flipping to manipulate property value by only revealing the ultimate purchaser.

Networks

In some cases of tax evasion, it was observed that there were networks of real estate industry providers working together to misrepresent the real cost of goods and services they provide and underreport their profits, capital gains and commissions. Such networks are often family members who control different services linked to the industry, such as construction companies, real estate brokers and sales representatives, accountant, lawyers, and/or notaries.

[2] https://www.oecd.org/ctp/exchange-of-tax-information/42223621.pdf

financing and money laundering are seen in conjunction with tax evasion transactions and contextual indicators.

In multiple cases of tax evasion, the ultimate beneficiary of the property will attempt to conceal their identity through the use of straw buyers. Straw buyers serve as intermediaries to distance the funds from the ultimate beneficiary and conceal ownership. Transactions involving straw buyers often fail to be completed due to lack of reported income or proper documentation required to obtain a mortgage. Straw buyers are often students, non-residents, residents with strong familial ties outside of Canada, corporations or trusts. Fraudulent documentation such as altered T4 slips or pay stubs are frequently provided to mortgage brokers and banks from the straw buyer. Such schemes can also be characterized by a lack of information on foreign clients' overseas activities.

Other instances observed included multiple incoming electronic funds transfers structured below currency restrictions imposed by other countries, such as China and Iran[3], and sent to individuals in Canada, which are then invested in real estate. In some instances, electronic funds transfers are sent by multiple seemingly unrelated individuals and/or entities to one common beneficiary, who uses these funds to purchase property. When combined with challenges in verifying overseas information, there is an increased risk that reporting entities will be unable to identify how these funds are used in Canada.

Real estate brokers and sales representatives with past disciplinary issues related to fraud, money laundering and/or tax evasion, who are involved in the industry in other capacities, such as real estate development, represent a heightened risk for fraud and tax evasion. These individuals have the knowledge and potentially the motivation to avoid detection of illicit activities such as tax evasion and money laundering.

Real estate brokers and sales representatives acquiring properties, in some instances using cash, and reselling them quickly, also pose a risk of tax evasion and money laundering. Reporting entities should be particularly alert when property value appears to significantly exceed what the broker's/sales representative's business activities have supported and there are suspicions that the transactions are conducted on behalf of someone else.

Reasonable grounds to suspect and how to use indicators

How reporting entities determine if they submit a suspicious transaction report to FINTRAC (for either a completed or attempted financial transaction) requires more than a "gut feel" or "hunch," although proof of money laundering is not required. Reporting entities are to consider the facts, the context and money laundering or terrorist financing indicators of a transaction. When these elements are viewed together, they create a picture that is essential to differentiate between what may be suspicious and what may be reasonable in a given scenario. Reporting entities must reach reasonable grounds to suspect that a transaction, or attempted transaction, is related to money laundering before they can submit a suspicious transaction report to FINTRAC.

Indicators of money laundering can be thought of as red flags indicating that something may very well be wrong. Red flags typically stem from one or more characteristics, behaviours, patterns and other contextual factors related to financial transactions that make them appear inconsistent with what is expected or considered normal. On its own, an indicator may not initially appear suspicious. However, it could lead reporting entities to question the legitimacy of a transaction. This may prompt them to assess the transaction to determine whether there are further facts, contextual

[3] Foreign currency controls that limit capital flight or the imposition of economic sanctions on foreign jurisdictions represent two major drivers of underground banking. China and Iran are subject to these restrictions and have long established diaspora communities in Canada. See FINTRAC's Underground banking through unregistered money services businesses and Updated indicators: Laundering the proceeds of crime through underground banking schemes for more information.

elements or additional money laundering or terrorist financing indicators that would increase their suspicion to the point where submitting a suspicious transaction report to FINTRAC would be required.

Comprehensive and high quality suspicious transaction reports are essential for FINTRAC's analysis process and disclosure recipients. The information collected as part of the assessment to determine whether a suspicious transaction report is required should be included in Part G of the report. While proof of money laundering and/or terrorist financing is not required, suspicious transaction reports must contain the information that led to the suspicion. A well-completed suspicious transaction report should include who the parties involved are, when the transaction(s) occurred, what financial instrument(s) or mechanism(s) were used to conduct the transaction(s), where the transaction(s) took place, why the activity is suspected of being related to the commission of a money laundering offence and how the transaction(s) took place. Identifying information on all parties involved in the transactions and linking specific transactions of concern with relevant money laundering indictors is critical information to include in suspicious transaction reports. For more guidance on reporting suspicious transaction reports, see Reporting suspicious transactions to FINTRAC.

Money laundering and tax evasion indicators

Below are indicators related to laundering the proceeds of tax evasion in the real estate sector that reflect the types and patterns of transactions. Included also are contextual factors, which emphasize the importance of knowing your client. The risks of laundering the proceeds of tax evasion in the real estate sector vary depending on whether properties are residential, commercial, industrial or farming and will differ depending on the different roles involved, such as real estate developer, mortgage broker, private lender, client, etc. The indicators from FINTRAC's 2016 Operational Brief on indicators of money laundering in financial transactions related to real estate remain relevant, and should be considered in conjunction with the contextual tax evasion indicators found below. Indicators of money laundering must be present in order to submit a suspicious transaction report to FINTRAC.

These indicators should not be treated in isolation; on their own, these indicators may not be indicative of money laundering or other suspicious activity. They should be assessed by reporting entities in combination with what they know about their client and other factors surrounding the transactions to determine if there are reasonable grounds to suspect that a transaction or attempted transaction is related to the commission or attempted commission of a money laundering offence. Several indicators may reveal otherwise unknown links that, taken together, could lead to reasonable grounds to suspect that the transaction or attempted transaction is related to the commission or attempted commission of a money laundering offence. It is a constellation of factors that strengthen the determination of suspicion. These indicators aim to help reporting entities in their analysis and assessment of suspicious financial transactions.

Money laundering and contextual tax evasion indicators associated with transactions in the real estate sector

- Financing for the purchase of property is provided by a private lender, unlicensed money services business, other than a financial institution, with no logical explanation provided.
- Transactions are passing through a mortgage broker, immigration consultants, and/or tax haven trust accounts.
- No guarantee securing the mortgage/interest payment has been established and no logical explanation provided as to why.
- There is an excessively high or low price attached to the securities, goods, properties transferred from the buyer to the seller without adequate supporting documents.

- ⊗ Transactions involve 'assignments of contract' where the same property is sold multiple times to different buyers and/or investors before being built and ready for occupancy.
- ⊗ Same property is resold multiple times to different middle investors, speculators, or private individuals between the moment it was sold to someone and before the property's closing date.
- ⊗ Different members of the same family control the main services linked to the real estate industry such as residential construction companies, real estate brokers and sales representatives, accountants, lawyers and/or notaries.
- ⊗ Transactions involving a person purchasing a property on behalf of another (straw buyer) who cannot complete the transaction, often due to lack of reported income or proper documentation required to obtain a mortgage.
- ⊗ The value of the property purchased is inconsistent with reported/stated wealth and income of client.
- ⊗ Statements from buyers as to the intended use of the property purchased (e.g., residence or investment) are inconsistent.
- ⊗ Investment vehicles or offshore accounts are used for the purchase of property.
- ⊗ Large amounts of money from foreign individuals or entities, located in a country that imposes limits on international transfers are wired through multiple smaller electronic transfers to be ultimately invested in real estate.
- ⊗ Real estate broker or sales representative with past disciplinary issues are engaged in real estate development.
- ⊗ Adverse media on the real estate professional or client involved in the transaction exists, linking them to criminal activity such as fraud, proceeds of crime, corruption/bribery, or tax evasion.
- ⊗ Real estate brokers or sales representatives are acquiring properties and reselling them quickly with unknown or third party funds, in some instances using cash.
- ⊗ Statements or questions are received from buyers as to how to avoid paying taxes on real estate property.
- ⊗ Cryptocurrencies are used as payment to property developers or investors and/or speculators.

Reporting to FINTRAC

To facilitate FINTRAC's disclosure process, please include the term #CRARealEstate in Part G—Description of suspicious activity on the suspicious transaction report.

Contact FINTRAC

Email: guidelines-lignesdirectrices@fintrac-canafe.gc.ca
Telephone: 1-866-346-8722 (toll-free)
Facsimile: 613-943-7931
Mail: FINTRAC, 24th Floor, 234 Laurier Avenue West, Ottawa, ON, K1P 1H7, Canada

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Canada

Resources

For more information on tax evasion in the real estate sector as well as associated financial intelligence, please consult the following resources:

Canada

- FINTRAC: Operational brief: Indicators of money laundering in financial transactions related to real estate
- CRA: How does the Canada Revenue Agency address non-compliance in the real estate sector?
- CRA: Leads Program

International

- AUSTRAC: Strategic analysis brief – money laundering through real estate
- Financial Action Task Force: Risk-based Approach Guidance for the Real Estate Sector
- Organisation for Economic Co-operation and Development: Report on Tax Fraud and Money Laundering Vulnerabilities Involving the Real Estate Sector

Appendix 1 – Example of how indicators might raise suspicion in real estate transactions

Background

Eve contacted Violet, a real estate sales representative, as she was interested in purchasing a residential property she saw for sale online for $895,000 located in the Greater Toronto Area (1234 Flower Lane). Eve explained that although she was currently overseas and would not be able to view it first, she was interested in buying the property and wanted to proceed with the deposit [**Trigger**: Transaction speed].

The deposit for the purchase of 1234 Flower Lane was wired to Violet from a business trust account located in the Seychelles. Eve explained that the deposit came from one of her companies, Bouquet A via a trust account in the Seychelles, and that the name on the purchase of the property would be Bouquet A [**Indicator**: Transactions are passing through a tax haven trust account] [**Indicator**: use of investment vehicles of offshore accounts for the purchase of property] [**Indicator**: Seeking anonymity by using different names on offers to purchase].

Initial suspicion is triggered

As a part of her customer due diligence responsibilities, Violet conducted an open source investigation to complete the information for the file, and while doing so, discovered that Eve is not the owner of Bouquet A, but instead appears to be the owner of Garden of E, an overseas shipping company, with a reported income not in line with the value of the property Eve is seeking to purchase [**Indicator**: Evidence of untruthfulness on behalf of the client (e.g., providing false or misleading information)] [**Indicator**: The value of the property is not consistent with reported/stated wealth and income of client]. Further searching by Violet found that the owner of Bouquet A is her boyfriend and business associate, Sage. When questioned about the inconsistencies in the ownership of Bouquet A, Eve stated that Sage was very occupied with business matters and as such, is currently hard to get a hold of [**Indicator**: Transactions involving a person purchasing a property on behalf of another] [**Indicator**: The client refuses to provide information when required, or is reluctant to provide information].

Trail of additional indicators and decision to report suspicions to FINTRAC

Further open source searches revealed that Eve is the daughter of a foreign politically exposed person (PEP), and has previously been charged with six counts of tax evasion for failing to file returns for a France-based company they she ran with her sister, Daisy, called Wreath Inc. [**High risk client**: family member of a PEP] [**Indicator**: Transactions involve persons or entities identified by the media, law enforcement and/or intelligence agencies as being linked to criminal activities]. As Eve is the daughter of a PEP, using property and land registry records, Violet has confirmed that she owned at least 13 properties in various countries, including the United Kingdom, Hong Kong, the United States, and the United Arab Emirates.

As a result of the overall level of suspicion raised by the combination of observable factors linked to indicators of suspicion, a suspicious transaction report was submitted to FINTRAC.