

Master Builders Australia

*Foreign Investment in Australian Real Estate:
Response to the Australian Government's
Options Paper*



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1 Introduction

- 1.1 Master Builders Australia is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders Australia's members are the Master Builder state and territory Associations.
- 1.2 Over 125 years the movement has grown to over 32,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.
- 1.3 The building and construction industry is a major driver of the Australian economy and makes a major contribution to the generation of wealth and the welfare of the community, particularly through the provision of shelter.
- 1.4 At the same time, the wellbeing of the building and construction industry is closely linked to the general state of the domestic economy.

2 Overview

- 2.1 The House of Representatives Standing Committee on Economics undertook a major inquiry into Foreign Investment in Australian Real Estate, issuing its final report in November 2014.
- 2.2 Amongst the main findings, and associated recommendations, of the report were:
 - there was no timely or accurate data on foreign investment in Australian real estate, which could be remedied by the establishment of a national register of land title transfers;
 - there were significant, and systemic, shortcomings in the leadership of the Foreign Investment Review Board, the key Federal agency responsibility for administering Australia's foreign investment framework and laws;
 - the current penalty regime was inadequate, and did not deter foreign investors from breaching Australian law, which could be remedied by strengthening criminal and civil penalties; and,

- Australian taxpayers' currently fund the public administration of the foreign investment review process, which should be replaced by a user pays model where foreign investors in Australian real estate pay a modest application fee.
- 2.3 Master Builders made a substantive submission to the inquiry pointing out, inter alia, foreign investment in Australian real estate accounted for between 5 and 8 per cent (and possibly as much as 12 per cent) of overall demand for new residential properties in recent years – a not inconsequential share.
- 2.4 The Australian Government responded to the Parliamentary report's findings and recommendations in the release of an Options Paper on approaches to strengthening Australia's foreign investment framework.
- 2.5 Master Builders is concerned the Options Paper failed to address, either per se, adequately or with sufficient justification, a number of the key findings of the House of Representatives' report.
- 2.6 These shortcomings, which should be remedied in a revised and re-issued for further public comment form of the Options Paper include:
- what action the Federal Government has or will be taking to address the deficiencies in the leadership of the Foreign Investment Review Board;
 - what action the Federal Government has or will be taking to improve the foundational data collection (essential for the proposed data matching) recommended by the Parliamentary Report;
 - providing robust evidence to justify the proposed increase in criminal and civil penalties for breaches of Australian foreign investment laws, given the rare and exceptional instances of proven cases in recent years (suggesting a very high incidence of compliance with those laws); and,
 - providing robust evidence to justify the proposed foreign investment application fee schedule, including four year ahead forward estimates of expenditures and revenue, given initial estimates suggest the likely net revenue more resembles a new tax on foreign investment than genuine user pays.

3 Parliamentary Report

- 3.1 The House of Representatives Standing Committee on Economics undertook a major inquiry into Foreign Investment in Australian Real Estate, publishing its final report in November 2014 (HRSCE 2014).
- 3.2 Amongst the terms of reference for the HRSCE inquiry were an examination of:
- the benefits of foreign investment in Australian residential property;
 - whether foreign investment increased the supply of new residential housing, and delivered benefits to the construction industry and its suppliers; and,
 - whether the administration of Australia's foreign investment regime, as it relates to residential property, can be enhanced.
- 3.3 Master Builders made an expansive submission to the HRSCE inquiry (Master Builders, 2014).
- 3.4 Amongst the main points made in our submission (and in related evidence to the HRSCE in public hearings) were foreign buyers:
- account for between 4 and 7 per cent of overall demand for established residential properties in Australia; and for between 5 to 8 per cent, and likely not more than 12 per cent, of overall demand for new residential properties in recent years;
 - add directly to the housing stock (purchasing new residential property); and,
 - add indirectly to the housing stock when their purchases of existing residential properties facilitate the vendors of those properties subsequently purchasing other new residential property (as can be the case with down-sizers).

3.5 Against this background, Master Builders stated (at pages 3 – 4):

the appropriate policy response is not to impede demand (by discouraging foreign investment in Australian real estate) but to reform and liberalise the supply side of the Australian housing market.

3.6 The appropriate policy response would build on Master Builders National Housing Affordability Agenda (NHAA), which advocates, inter alia:

- the Federal Government provide ex post 'competitive, efficiency dividend' payments to the State, Territory and Local Governments for delivering housing supply policy outcomes against key performance metrics;
- local governments develop individual Land Release Plans, and associated marketing strategies, for their own jurisdictions over a ten year ahead rolling time horizon;
- the realisation of a genuine, rigorous, enforceable, transparent and uniform building code and regulatory system;
- a review of the impact of stamp duties on residential property, and alternate approaches to revenue-raising, recognising such transaction costs are inefficient taxes and impede movement within the housing and labour markets;
- the annual publication of a rigorous stocktake of the approaches to developer/infrastructure charges by all local governments in Australia; and,
- commitments by all governments to deliver substantive outcomes which will raise labour productivity growth rates, including greater flexibility in labour markets emphasising genuine enterprise bargaining.

3.7 Master Builders continues to regard the NHAA as central to improving housing affordability and supply in Australia.

- 3.8 The HRSCE's final report made a number of noteworthy findings, including:
- 3.8.1 there is no timely or accurate data on foreign investment in Australian real estate. This deficiency could be overcome by establishing a national register of land title transfers, which records the citizenship and residency status of all buyers of Australian real estate (reflected in Recommendation 8);
 - 3.8.2 there *"has been a significant failure of leadership at FIRB ... The systems failure at FIRB needs to be repaired..."* (page v). The Report did not expand, or make a specific recommendation, on how this deficiency should be remedied, presumably leaving it to the leadership of Federal Government agencies (that is, the Treasury);
 - 3.8.3 the current penalty regime is inadequate, and does not deter entities from breaching Australia's foreign investment laws. The Report proposed increasing civil penalties for breaches of applicable law(s) (reflected in Recommendations 4 to 7 inclusive); and,
 - 3.8.4 Australian taxpayers currently fund public administration of the foreign investment review process. The Report proposed a shift to a user pays model, under which foreign investors in Australian real estate pay a modest application fee.
 - 3.8.5 This application fee would be used to fund the enhanced data collection, audit, compliance and enforcement activities proposed elsewhere in the Report (reflected in Recommendation 3).

4 The Options Paper

- 4.1 The Federal Government released in late February 2015 an Options Paper setting out a package of proposed reforms to Australia's foreign investment law and policy framework (Australian Government, 2015).
- 4.2 Amongst these proposed reforms were:
 - the creation of a specialised investigative and enforcement area with the Australian Taxation Office (ATO) to improve compliance with Australian foreign investment law;

- amending relevant laws to increase existing criminal penalties and to create new civil pecuniary penalties and infringement notices;
- the introduction of application fees for all foreign investment proposals “*in line with a user pays system*” (page 2); and,
- the establishment of a foreign ownership register to collect information on existing foreign ownership and all subsequent transactions of all interests in agricultural land.

4.3 Master Builders was initially surprised to see the Australian Government vest primary administrative responsibility for compliance and enforcement in the Australian Taxation Office (ATO). This proposed arrangement contrasts with primary decision-making responsibility for foreign investment applications and policy making residing with the Foreign Investment Review Board (FIRB), an agency of the Australian Treasury.

4.4 However, this splitting of functions likely reflects the Federal Government’s implicit acceptance of the second main finding of the HRSCE Report (at page v):

... there has been a significant failure of leadership at the FIRB, which has been unable to provide basic compliance information to the committee about its investigations and enforcement activity.

and (ibid):

The systems failure at FIRB needs to be repaired ...

4.5 This situation raises in turn three further issues:

- the failure of the Options Paper to set down what concrete steps have been/will be taken to address the systemic and significant failure of leadership of FIRB identified by the HRSCE Report;
- given the inability of the FIRB to provide basic information about compliance and enforcement issues, how can the Federal Government sustain its claim for enhanced criminal and civil penalties; and,

- how confident is the Federal Government that shifting compliance responsibility to the ATO will resolve the systems failure identified in the Parliamentary report, or is it effectively a mechanism for raising additional revenue (in which case it is poor public policy)?
- 4.6 Master Builders regards the failure of the Options Paper to outline what concrete steps the Australian Government is/will be taking to address the systemic and significant failure of the FIRB as a major omission from this important statement.
- 4.7 At the very least, the Federal Treasurer should make a statement to Parliament outlining what concrete steps the Federal Government has taken/will be taking to address these systemic and failures within the FIRB, sufficient to ensure they do not continue into the future.
- 4.8 Master Builders regards as incongruous for the Federal Government to propose an enhanced enforcement regime, with expanded criminal and civil penalties, when its own agencies before a Parliamentary inquiry cannot “*provide basic compliance information*” - that is, provide the necessary evidentiary foundation for these increased penalties.
- 4.8.1 The claim made in the HRSCE Report (at page v) that “*It defies belief that there has been universal compliance with the foreign investment framework ... since 2007.*” does not of itself constitute sufficient justification for the proposed increased penalty regime.
- 4.8.2 It would be an unsafe principle and practice for good public policy for changes in statute law which impose greater criminal and civil penalties to be based on government failure (to collect the necessary information) or on the absence of the necessary evidence.
- 4.8.3 The absence of any successful prosecutions for breaches of Australia’s foreign investment laws may well reflect the effectiveness of the existing laws, and the very high levels of compliance with them.
- 4.8.4 Taken as a whole, the Federal Government has not demonstrated, with robust evidence, the need to expand the criminal and civil penalty regime within Australian foreign investment law.

- 4.9 A key feature of the Options Paper is the proposal (outlined in Section 5 of the Paper) to impose fees for foreign investment applications for both residential and commercial property.
- 4.10 The main elements of the proposed new arrangements include:
- a fee would be imposed for all foreign investment applications;
 - the money thus raised would be used to fund screening, compliance and enforcement activities, and improved data collection, on foreign investment; and,
 - the applications would need to be made, and the fees paid, before their foreign investment submission was processed.
- 4.11 The Options Paper in an unnumbered table (to be found on page 14) sets down a schedule for the possible framework for the proposed fee on foreign investment applications, categorised by sector (residential/business/agriculture), by type of investment (including size) and by proposed fee.
- 4.12 For example, under the proposed schedule a prospective foreign investor in a real estate property valued at up to \$1 million would pay an application fee of \$5,000 (the equivalent of a 0.5 per cent tax on the value of the asset being acquired). For a house valued at \$500,000, the application fee of \$5,000 would amount to a 1 per cent tax.
- 4.13 However, the Options Paper fails to discuss, let alone demonstrate, how the proposed fee schedule resembles the concept of genuine “*user pays*” (as stated at page 2 as an objective for the proposed changes).
- 4.13.1 The credibility of the Options Paper, and the arguments contained therein, would have been greatly enhanced, and made more persuasive, by the inclusion of four-year ahead forward estimates of the expenditure and income elements of the proposal.
- 4.13.2 That is, on the expenditure side, the expected cost of the enhanced data collections, and compliance and enforcement, et al, and on the income-side, the expected revenues from the new fee arrangements.

- 4.13.3 To the extent the revenues exceed the expenditures, and thus depart from true user pays, the new arrangements constitute a tax on foreign investment in Australian real estate.
- 4.14 As the Federal Government has conceded (Hockey, 2015) the new fee schedule is expected to raise around \$200 million annually.
- 4.15 Assuming the cost of the new data collection, and compliance and enforcement arrangements are less than (a very generous) \$20 million annually, the new foreign investment tax would amount to some \$180 million a year.
- 4.16 Master Builders has deep reservations about imposing a tax on foreign investment applications for the negative messages it would send to the global market place, and the adverse impact it would have on Australia's competitiveness as a destination for foreign investment (noting two of our major competitors, Canada and the United States, do not tax foreign investment applications).
- 4.17 Given Chinese investors in Australian residential property are price sensitive (with two thirds of respondents to a recent survey saying 'price was the biggest consideration when buying Australian real estate': Schlesinger, 2015), the impact of the new foreign investment tax is likely to be more substantial than may otherwise have been the case.
- 4.18 At the very least, and before the tax is introduced, the Parliamentary Budget Office (PBO) should prepare and publish a robust analysis of the fiscal impact (expenditures and revenues) of the proposed fee structure over the forward estimates horizon (that is, next four fiscal years).
- 4.18.1 A template for such an analysis reporting can be found at Appendix C of the HRSCE Report, where the PBO undertook a similar analysis for a more modest set of policy options.
- 4.18.2 To the extent any new charges are imposed on foreign investment applications they should not, individually or collectively, exceed 'true user pays' – that is, become a new tax on foreign investment in Australia.

5 Bibliography

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