

## **Explanatory Memorandum to**

### **The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) (Amendment) Regulations 2020**

This Explanatory Memorandum has been prepared by the Permanent Secretary's Group of the Welsh Government and is laid before the Senedd Cymru in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

#### **Minister's Declaration**

In my view, this Explanatory Memorandum gives a fair and reasonable view of the expected impact of the Land Transaction Tax (Tax Bands and Tax Rates) (Wales) (Amendment) Regulations 2020. I am satisfied that the benefits justify the likely costs. These changes will commence on 22 December 2020.

Rebecca Evans MS  
Minister for Finance and Trefnydd  
21 December 2020

## **1. Description**

- 1.1 The purpose of this instrument is to specify a change to the land transaction tax (“LTT”) percentage tax rates for higher rates residential property transactions, non-residential property transactions and chargeable consideration which consists of rent.

## **2. Matters of special interest to the Legislation, Justice and Constitution Committee.**

- 2.1 This instrument contains regulations made under the provisional affirmative procedure set out in section 25(2) of the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 (“the 2017 Act”). These Regulations are therefore made without a draft having been laid before, and approved by, the Senedd. Further details about this procedure can be found in paragraph 3.2, below.
- 2.2 This instrument also contains regulations made under section 78(1) of the 2017 Act to make transitional provision in connection with certain transactions where substantial performance, or contracts for the sale and purchase of the property are exchanged before 22 December 2020, but completion takes place on or after that date. Section 79(3) of the 2017 Act provides that regulations made under section 78(1) are subject to the negative procedure, unless the Welsh Ministers consider the regulations have the effect of imposing or increasing liability to tax. In this instance, the tax liability is increased with regards to the higher residential rates but decreased with regards to the non-residential rates and chargeable consideration which consists of rent. The transitional rule made under section 78(1) has the effect of protecting those taxpayers who have exchanged contracts before 22 December from paying more tax than they expected when they exchanged contracts. They will therefore only apply in relation to those transactions where there is an increase in liability, in this case, the higher residential property transaction alone. As a result of section 40 of the Legislation (Wales) Act 2019, the regulations are subject to the provisional affirmative procedure.

## **3. Legislative background**

- 3.1 Section 24 of the 2017 Act provides the Welsh Ministers with powers to vary the tax rates and tax bands for LTT through regulations.
- 3.2 Regulations made under this section are subject to a provisional affirmative procedure, which means the regulations are made (signed) by the Ministers and can come into force immediately. Once the Regulations have been made, they must be laid before the Senedd and will have temporary effect until they are voted on by the Senedd. That vote must happen within 28 calendar days of the regulations being made, not counting days when the Senedd is in recess. If the vote does not occur, or is lost, the former tax rates and tax bands again apply and any taxpayer who paid a higher amount of tax under the regulations that failed to achieve Senedd approval can reclaim the difference between that payable under those regulations and the rates previously in force. This means that the risk of the regulations failing to achieve Senedd approval will rest with the Welsh Government and not Welsh taxpayers.
- 3.3 As the Regulations have been made when the Senedd is in recess, the 28 day period commences on 11 January 2021 and the vote to approve the Regulations must occur by 8 February 2021.

#### 4. Purpose & intended effect of the legislation

- 4.1 The purpose of these Regulations is to change the percentage tax rates of LTT used to calculate liabilities for higher rates residential property transactions. The regulations also change the non-residential property transaction zero rate band and the chargeable consideration which consists of rent non-residential leases ('NRL') zero rate band both of which are used to calculate a taxpayers liabilities. These changes apply to transactions which have an effective date<sup>1</sup> on or after 22 December 2020 and were announced by the Minister for Finance and Trefnydd in the draft Budget on 21 December 2020. These Regulations make no changes to the main residential rates of LTT which, broadly, apply to residential properties purchased as a primary residence.
- 4.2 The effect of these Regulations is to increase the higher rates of LTT applied to relevant residential property transactions by 1 percentage point in each tax band (i.e. the first tax band is increased from 3% to 4%, the second tax band increases from 6.5% to 7.5% etc.) This change will increase tax for around 14,000 taxable higher rates residential transactions per year by an average of around £1,600.
- 4.3 The effect of the Regulations on the zero rate tax bands applying to non-residential property transactions and the chargeable consideration which consist of rent is to decrease the amount of the LTT liable per transaction by taxpayers compared to the rates in force before 22 December 2020 by increasing the zero rate tax bands. In relation to the non-residential rates applicable to non-residential property transactions, the Regulations amend the first tax band so that it increases the threshold of the zero rate tax band from £150,000 to £225,000, and amends the first tax band so that it covers transactions of 'more than £225,000 but not more than £250,000'. There is no amendment to the rate in the first tax band which remains at 1% and the second and third tax bands are unchanged. In relation to the chargeable consideration which consists of rent, the NRL zero tax band is increased from £150,000 to £225,000 and the first tax band is amended so that it covers transactions of 'more than £225,000 but not more than £2,000,000'. The second tax band is unchanged.
- 4.4 These Regulations do not make any changes to the tax bands and percentage tax rates applicable to the main rates residential property transactions. Temporary changes to the main rates of LTT applicable to residential property transactions were made by the Land Transaction Tax (Temporary Variation of Rates and Bands for Residential Property Transactions) (Wales) Regulations 2020<sup>2</sup> ("the 2020 temporary LTT Regulations"). Those Regulations increased the residential main rates threshold from £180,000 to £250,000 for the period 27 July 2020 until 31 March 2021 inclusive. On 1 April 2021 the threshold to the main residential rates zero rate band will revert back to £180,000 as provided for in The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) Regulations 2018<sup>3</sup> ("the 2018 LTT Regulations").
- 4.5 The effect of these Regulations will provide additional revenue to Welsh Government to finance public spending, through the increases in the rates of tax applied to higher rates residential property transactions. At the same time supporting business, predominantly small and medium sized enterprises, by reducing the costs when acquiring non-residential property, transferring or taking out new leases, depending on the cost. This approach

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<sup>1</sup> The 'effective date' is the date of completion of the contract to purchase the property. See section 71 of the 2017 Act.

<sup>2</sup> The Land Transaction Tax (Temporary Variation of Rates and Bands for Residential Property Transactions) (Wales) Regulations 2020 (S.I. 2020/794 (W.174)).

<sup>3</sup> The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) Regulations 2018 (S.I. 2018/128 (W. 32)) makes provision as to the rates and bands of LTT applicable to residential property transactions, higher rates residential property transactions, non-residential property transactions, and transactions where chargeable consideration consists of rent.

provides for a more progressive tax regime for LTT which recognises that the support required for economic recovery from the COVID-19 pandemic will require long-term investment.

- 4.6 Separate draft affirmative regulations that will make changes to the specified amount of relevant rent will be laid shortly. The relevant rent amount applies to non-residential transactions where the buyer is granted a lease and pays both rent and consideration other than rent (for example a premium). It is intended that the Land Transaction Tax (Tax Bands and Tax Rates) (Wales) (Amendment) Regulations 2020 and the Land Transaction Tax (Specified Amount of Relevant Rent) (Wales) (Amendment) Regulations 2021 will be debated in the Senedd on the same day. The intended effect and purpose of those Regulations are set out in their accompanying Explanatory Memorandum.
- 4.7 The LTT residential property higher rates will, for transactions completed on or after 22 December 2020 be:

**Table 1: Residential Property Transactions - Rates and Bands from 22 December 2020**

<b>Higher rates residential property transactions</b>		
<u>Tax band</u>	<u>Relevant consideration</u>	<u>Percentage tax rate</u>
First tax band	Not more than £180,000	4%
Second tax band	More than £180,000 but not more than £250,000	7.5%
Third tax band	More than £250,000 but not more than £400,000	9%
Fourth tax band	More than £400,000 but not more than £750,000	11.5%
Fifth tax band	More than £750,000 but not more than 1,500,000	14%
Sixth tax band	More than £1,500,000	16%

4.8 The LTT non-residential property rates will, for transactions completed on or after 22 December 2020, be:

**Table 2: Non-Residential Property Transactions - Rates and Bands from 22 December 2020**

<b>Non-residential property transactions</b>		
<u>Tax band</u>	<u>Relevant consideration</u>	<u>Percentage tax rate</u>
Zero rate band	Not more than £225,000	0%
First tax band	More than £225,000 but not more than £250,000	1%
Second tax band	More than £250,000 but not more than £1,000,000	5%
Third tax band	More than £1,000,000	6%

4.9 The LTT rates applicable to the chargeable consideration which consists of rent will, for transactions completed on or after 22 December 2020, be:

**Table 3: Chargeable consideration which consists of rent - Rates and Bands from 22 December 2020**

<b>Chargeable consideration which consists of rent</b>		
<u>Tax band</u>	<u>Relevant consideration</u>	<u>Percentage tax rate</u>
NRL Zero rate band	Not more than £225,000	0%
First tax band	More than £225,000 but not more than £2,000,000	1%
Second tax band	More than £2,000,000	2%

## 5. Consultation

- 5.1 There is no statutory requirement to consult on this instrument. The changes to the percentage tax rates and tax bands for higher rates residential property transactions, non-residential property transactions and chargeable consideration which consists of rent were announced by the Minister for Finance and Trefnydd on 21 December 2020 in the draft Budget. The approach taken follows the Welsh Government's tax policy principles for a progressive regime by providing a tax saving to some non-residential transactions as businesses seek to recover from the impact of the COVID-19 pandemic, as well as increasing LTT revenues overall to provide additional revenue to finance Welsh Government policy priorities. The setting of rates and thresholds for taxes is not an area of policy where consultation is generally undertaken, as any such consultation with a 'live' tax is highly likely to have a distortive effect on behaviours and, in relation to transaction taxes, the timing of those transactions.

## 6. Regulatory Impact Assessment

- 6.1 The revenue impact of these changes are provided alongside the Welsh Government's draft Budget published on 21 December 2020. The costing of the policy has been included in the Office for Budget Responsibility's forecasts of land transaction tax (LTT) for the Welsh Government's draft Budget.
- 6.2 The Welsh Government considered a number of options for changes to land transaction tax rates and thresholds. This assessment covers a no change option and the policy within these regulations.
- 6.3 When setting rates and tax bands there are many possible options, especially when the changes affect more than one table of tax bands and tax rates. This regulatory impact assessment provides details of a no change and options selected only. The option selected included two changes, firstly, an increase to the tax charged on higher residential rates property transaction of one percentage point for each tax band. The decision to increase the tax charged on these property transactions was made to provide an increase in the resources available to the Welsh Government to spend on essential public services and spending plans.
- 6.4 Some of those additional revenues have been used to offset the costs of the second change, an increase in the non-residential tax bands applied to consideration paid for non-residential property transactions and to chargeable consideration which consists of rent. The decision was to provide buyers of non-residential property with, generally, a maximum LTT reduction of £750 to the cost of their non-residential transaction. It is designed in the simplest way possible and proportionally will have greatest impact on small and medium enterprises, including those in the foundational economy. Those businesses buying non-residential properties costing between £150,000 and £225,000 should, in the main, no longer have a tax liability (previously those buying property costing up to £150,000 did not pay LTT). The changes should help businesses reshape their property assets as we emerge from the pandemic to fit their requirements, be that to expand, or to reduce, the property assets used in the business.

### *No change*

- 6.5 The no change option would have left all rates and thresholds for the residential and non-residential taxes as they have been since 1 April 2018 when LTT first applied in Wales, with the exception of the temporary variation to the residential main rates provided for in the 2020 temporary LTT Regulations. The temporary variation to the residential main rates of LTT

remain in effect until 31 March 2021 and on 1 April 2021, the main residential rates and thresholds revert to those set out in 2018 LTT Regulations.

*Increase the higher residential rates of LTT by 1 percentage point in each tax band*

- 6.6 This option will increase the tax paid on residential property transactions subject to the higher rates. The higher residential rates apply to companies buying any dwellings and to individuals, broadly, who are buying residential properties when they, or an individual they are buying with, already own an interest in another dwelling. This is most likely to apply to the purchases of second homes and buy-to-let properties. The tax change effectively increases the additional tax these properties pay from 3% to 4% relative to a main rates residential property.
- 6.7 There are no changes to the main residential rates of LTT in this option; however, the end of the temporary variation period and return to the rates and thresholds provided for in the 2018 LTT Regulations, as described at paragraph 6.5, will occur.
- 6.8 This option ensures the increase in tax burden is restricted to those with the resources to purchase additional residential properties and therefore provides for a more progressive regime, in line with the Welsh Government's tax policy principles. Purchasers who pay the higher residential rates account for around 25% of all residential purchases each year, although some may subsequently be entitled to a refund of the higher residential rates with their transaction then subject to the main residential rates. Such repayments can be made by, for example, people 'bridging' between one main residence and their new one.
- 6.9 Based on 2019-20 data, around 14,000 residential property transactions are initially subject to the higher residential rates. Using the same data, the change increases tax by an average of around £1,600 per transaction. The changes are anticipated to provide an increase in LTT revenues in 2021-22 of £14million. This revenue estimate includes the latest economic forecasts for the property market published by the Office for Budget Responsibility in their Economic and Fiscal Outlook (November 2020), anticipated refunds from the higher rates and expected behavioural effects in response to the measure. The behavioural effects expected with this option are likely to slightly reduce the prices and transaction numbers for properties subject to the higher residential rates as well as having a small effect on reducing house prices more generally. These all act to reduce the expected revenue from the measure and are included in the estimate. Many factors affect property transaction numbers and prices over and above the tax charged on purchases. The full effect is difficult to estimate for these multiple factors and, in particular, the short and medium-term impact of the COVID-19 pandemic on the property market and the wider economy is highly uncertain. The scale of the behavioural effects are also relatively uncertain. In addition, as some additional properties may also be buy-to-lets, this measure may also slightly increase residential rents.
- 6.10 This option increases the tax difference between different types of residential purchases in Wales. The relative reduction in tax for home buyers compared to second home and buy-to-let purchases may also change the composition of residential transactions. This may slightly increase the share of homebuyer transactions in Wales.

*Increase the threshold to the zero rate tax band for the non-residential rates of LTT and the zero rate tax band on the chargeable consideration which consists of rent*

- 6.11 This option will reduce LTT charged for certain non-residential transactions. It increases the zero rate band for lease premiums and assignments, and property transfers from £150,000 to £225,000. This provides a tax saving of up to £750 compared to the system between 1 April 2018 and 21 December 2020. The change also increases the zero rate band of the tax charged on the rent element of non-residential leases (measured by the net present value of the rents payable on the granting of a lease) from £150,000 to £225,000. This ensures

consistency in the treatment of the consideration given for a freehold or a premium on the granting or assigning of a lease with the consideration given in the form of rent. This measure also provides a tax saving of up to £750 for certain newly granted non-residential leasehold transactions.

- 6.12 This option will reduce tax for just under 1,500 non-residential transactions per year which involve a freehold transfer, or the granting or assignment of a lease. It is also estimated, the non-residential rent zero rate band change would reduce tax for just under 1,000 transactions per year for transactions involving rent on the grant of a lease, some of which may benefit from the both measures. These measures are more likely to benefit small and medium sized businesses (SMEs), whilst also providing the same maximum tax reduction for some larger non-residential transactions. These changes may slightly increase commercial property prices and transactions. The changes are forecast to reduce LTT revenues in 2021-22 by £1million.

### *Summary*

- 6.13 When taken together, the changes represent a measured tax increase in Wales for certain residential property transactions whilst providing a modest tax reduction to non-residential transactions. The effect combined will increase overall LTT revenues increasing the resources available to the Welsh Government to finance policy priorities and reduce the expenditure required by businesses to invest in commercial property.
- 6.14 There will be little additional administrative cost to the Welsh Revenue Authority ('WRA') as a result of updating its online tax calculators and responding to taxpayer queries about the change. These costs will be met within its current budget. Businesses involved in the various stages of house purchases, especially estate agents and conveyancers and solicitors have dealt with many rate (and method of calculation) changes before when SDLT operated in Wales and with the introduction of LTT in Wales. A Written Statement and press notices have been published and provided and the Welsh Government has engaged with professional bodies to help communicate these changes to Welsh taxpayers. The WRA has updated its guidance and provided a revised LTT calculator to establish liability. The additional administrative costs to businesses should therefore be minimal.
- 6.15 These regulations are not expected to impact on competition or the competitiveness of Welsh businesses.

## **7. Post Implementation review**

- 7.1 Section 77 of the 2017 Act provides that the Welsh Ministers must make arrangements for an independent review of land transaction tax to be completed within six years of the day after the day of the 2017 Act receiving Royal Assent. A review of LTT will encompass all of the subordinate legislation made under the 2017 Act.