

Explanatory Memorandum to

The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) Regulations 2018

This Explanatory Memorandum has been prepared by the Office of the First Minister and Cabinet Office of the Welsh Government and is laid before the National Assembly for Wales in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

Cabinet Secretary'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) Regulations 2018. I am satisfied that the benefits justify the likely costs.

Mark Drakeford AM – Cabinet Secretary for Finance
8 January 2018

1. Description

- 1.1 The purpose of this instrument is to specify the tax bands and percentage tax rates for land transaction tax (“LTT”), which is introduced by the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 (“the LTT Act”).

2. Matters of special interest to the Constitutional Affairs Committee

- 2.1 None.

3. Legislative background

- 3.1 Section 24(1) of the LTT Act and paragraph 28(1) of Schedule 6 make provision to specify tax bands and percentage tax rates for LTT.
- 3.2 In accordance with section 25(1) of the LTT Act, these regulations will be subject to the affirmative procedure. However, any variation to the rates and bands contained in these regulations will need to be given effect through further regulations, which will be subject to a provisional affirmative procedure in accordance with section 25(2) of the LTT Act.

4. Purpose & intended effect of the legislation

- 4.1 These regulations will specify the first tax bands and percentage tax rates for LTT. They have effect in relation to land transactions with an effective date on or after 1 April 2018. Separate tax bands and percentage tax rates apply to:
- Residential property transactions;
 - Higher rate residential property transactions;
 - Non-residential property transactions; and
 - Chargeable consideration which consists of rent (and therefore which is only relevant in the case of non-residential leases).
- 4.2 The intended effect of the regulations is to provide for the first set of tax bands and tax rates which will be used to calculate the amount of LTT chargeable in respect of a land transaction. Following the setting of the first set of tax bands and rates, the Welsh Ministers will have the ability to change or introduce new bands and rates in LTT with immediate effect (as per the rules under the provisional affirmative procedure).
- 4.3 Tax is to be calculated in accordance with sections 27 and 28 of the LTT Act except where the chargeable consideration consists of rent. In these cases, tax is to be calculated in accordance with Part 3 of Schedule 6 to the LTT Act.
- 4.4 The tax bands and rates will apply to transactions liable to LTT. There will be some transactions which have an effective date after the go-live date that may remain liable to SDLT in accordance with the Land Transaction Tax (Transitional Provisions) (Wales) Regulations 2018, and the Wales Act 2014.

5. Consultation

- 5.1 The Welsh Government carried out a public consultation 'Tax Devolution in Wales – Land Transaction Tax' in relation to the Land Transaction Tax primary legislation from February to May 2015. Consultees included practitioners, advisory bodies, other stakeholders and the wider public. The consultation sought views on setting rates and bands in Wales and whether Welsh Ministers should have the ability to change or introduce new rates and bands in LTT with immediate effect. Some respondents thought the current SDLT rates and bands were suitable for Wales. However, there was also recognition of the fact that Wales has lower property values and suggested bands that could be adjusted to reflect this. Most respondents agreed that the setting of rates and bands would be a decision for Welsh Ministers. A detailed analysis of the responses to the consultation is available on the Welsh Government's website¹.
- 5.2 Following the responses to this consultation, and the feedback from stakeholders that setting rates and bands is a decision for Welsh Ministers, no consultation has been undertaken specifically on the actual rates and bands. However, a Treasury Paper on 'Land Transaction Tax: Setting Rates and Bands'² was published in September 2016. The focus of the research paper was to set out the context and issues which will need to be taken into consideration when setting tax rates and bands that are appropriate for Wales.
- 5.3 Regular engagement continued during the passage of the LTT Bill on tax rates and bands with key stakeholders, including the Tax Forum (tax experts and professional groups) and Tax Advisory Group.

6. Regulatory Impact Assessment

- 6.1 With very few exceptions, required by the provisions of the Wales Act 2014, stamp duty land tax will cease to apply in Wales from 1 April 2018. By providing a replacement tax, and specifically replacement tax bands and rates, public services in Wales will continue to receive the benefit of the revenues raised by a tax on land transactions.
- 6.2 Two options have been considered here;

Option 1: To replicate stamp duty land tax rates into LTT; and

Option 2: To introduce tax rates which differ to stamp duty land tax. ***This is the preferred option.***

Assessment of option 1

- 6.3 As LTT will replace stamp duty land tax, option 1 with tax rates the same as those currently prevailing would result in no impact compared to the current situation in Wales. No further assessment is made of this option.

Assessment of option 2

- 6.4 As option 2 would result in different tax rates compared to those which currently prevail in Wales, these would have some impact. An assessment of the first LTT rates and bands is provided below which covers each element of the tax. As the tax will replace stamp duty land tax, the impact is assessed in relation to the prevailing tax rates in Wales.

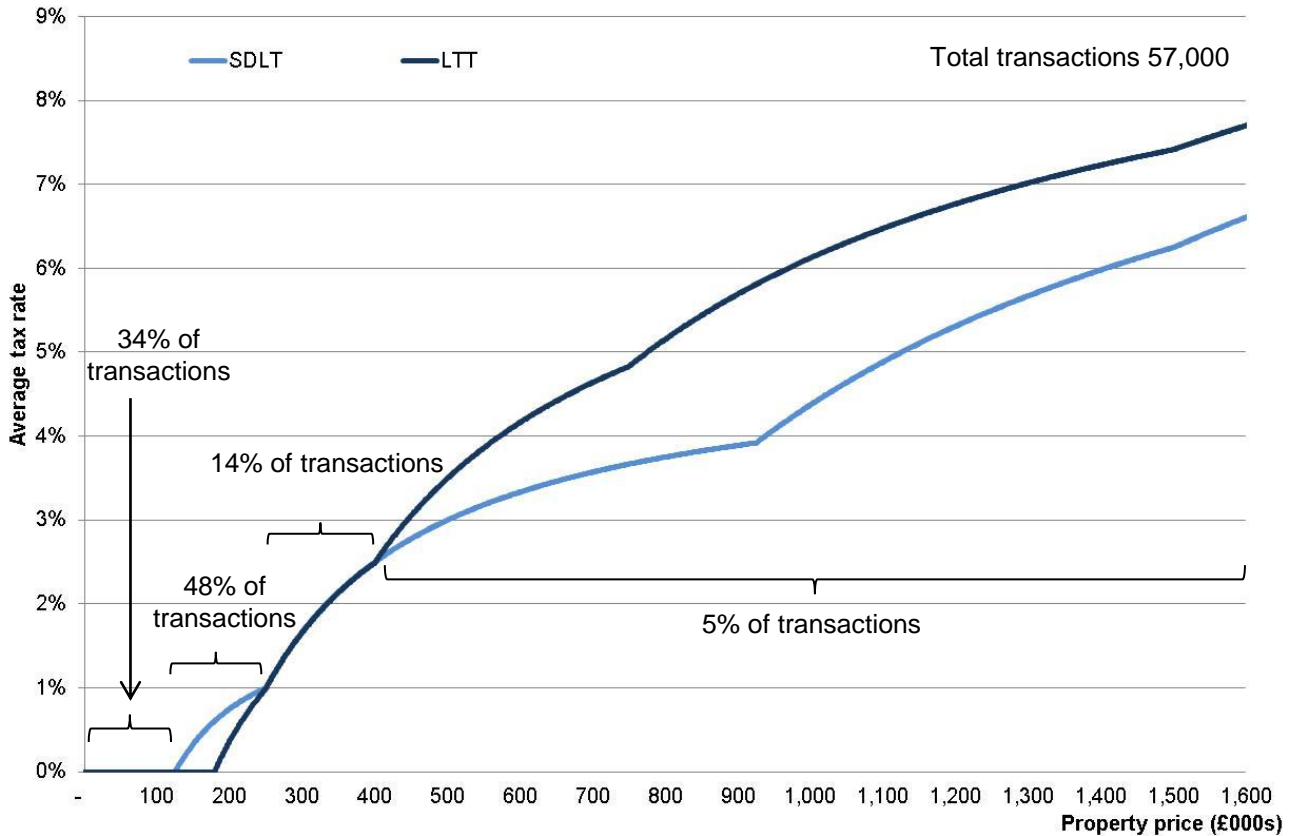
¹ <http://gov.wales/betaconsultations/finance/land-transaction-tax/?lang=en>

² <http://gov.wales/docs/caecd/publications/160915-ltt-bands-en.pdf>

Main residential rates

- 6.5 Overall in 2018-19 it is estimated around 32,000 transactions (56% of all residential transactions) will pay less tax following the introduction of LTT rates, and around 6,000 transactions (or 11%) will pay more relative to stamp duty land tax. The remainder, around 19,000 residential transactions, will continue to pay the same tax as with stamp duty land tax (which will be no tax unless the higher rates on residential transactions apply).
- 6.6 To assess the impact of LTT residential main rates, these are compared to the stamp duty land tax residential main rates. The chart below shows this, using the average tax rate as this allows the effect of the different tax rates and thresholds to be reflected.

Figure 1 – Average tax main residential rates of LTT and SDLT



Source: Welsh Government estimates based on HMRC administrative datasets
 NB numbers may not sum due to rounding

- 6.7 In total, there are estimated to be around 57,000 residential transactions in Wales in 2018-19. However, not all of these will be affected by the introduction of LTT as both stamp duty land tax and LTT have a zero average tax rate below £125,000. In Wales, it is forecast that around 19,000 transactions (around a third of transactions) will be in this price range in 2018-19 when LTT rates first apply. Therefore there will be no impact on transactions in this price band from the introduction of LTT.
- 6.8 For purchase prices between £125,000 and £180,000, stamp duty land tax would be liable up to a maximum of £1,100 for non-first-time buyers. With LTT, no tax will be liable regardless of whether the purchaser is a first-time buyer or not. It is estimated that there will be around 17,000 transactions (or around 30 per cent of transactions) in this price range. This price band includes the latest average house price in Wales; at £153,316 (ONS December 2017). Therefore no LTT will be liable at the current average house price in Wales, whereas with stamp duty land tax £566 tax would be liable.
- 6.9 Overall in 2018-19 around 36,000 transactions (or 63% of residential transactions) will therefore not be liable for LTT with the main rates as they will be below £180,000.
- 6.10 For residential transactions between £180,000 and around £400,000, the tax liable under LTT will be lower than stamp duty land tax (unless the transaction is undertaken by a first-time buyer). The tax rate from £180,000 up to £250,000 will be higher under LTT (3.5% compared to 2% under stamp duty land tax), but this is more than offset by the higher starting threshold with LTT. Around 18,000 (or around a third) of transactions are estimated to be within the £180,000 and £400,000 price band.
- 6.11 There will be a tax reduction for non-first-time buyers between £180,000 and £250,000 of up to £1,100. It is estimated that there will be around 10,000 (or around 18%) of transactions in this price band.
- 6.12 For transactions between £250,000 and £400,000 the tax liability for non-first-time buyers will be £50 lower with LTT than stamp duty land tax. It is estimated that there will be around 8,000 (or 14% of) transactions in this price band.
- 6.13 For transactions from around £400,000, the tax liability will be higher under LTT than stamp duty land tax. In 2018-19 this is forecast to affect less than 3,000 transactions - the top 5% of transactions. For a transaction at £500,000, the tax liability under LTT will be £17,450 compared to £15,000 under stamp duty land tax. Transactions from £500,000 upwards are expected to account for around 1,000 transactions (or around 2% of all transactions) in 2018-19. From £925,000 upwards, the maximum difference between stamp duty land tax and LTT is £17,450. There are expected to be less than 100 transactions at this price band.

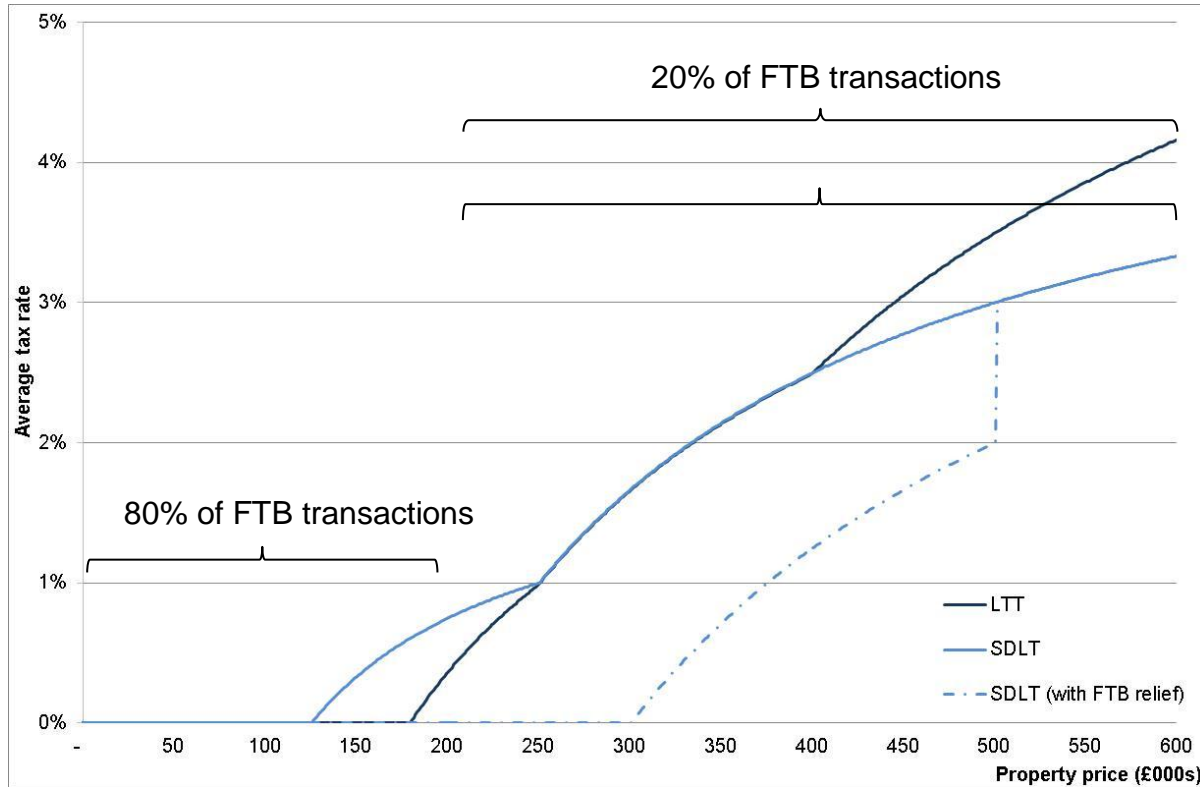
Table 1: summary of main residential rates

Property price	Change in tax from SDLT to LTT (excluding first-time buyers)
£125,000 or less	No change
£125,001-£180,000	Lower tax under LTT (up to £1,100 difference)
£180,001-£250,000	Lower tax under LTT (up to £1,100 difference)
£250,001-£401,000	Lower tax under LTT (up to £50 difference)
£401,001-£750,000	Higher tax under LTT (up to £8,700 difference)
£750,001+	Higher tax under LTT (up to £17,450 difference)

First-time buyers

6.14 Since the UK Autumn Budget 2017, under stamp duty land tax, first-time buyers (FTBs) do not pay tax up to £300,000 and then have a reduction in tax of £5,000 for transactions with consideration between £300,000 and £500,000. From £500,000, first-time buyers receive no reduction in stamp duty land tax. The stamp duty land tax rates, with and without the first-time buyer relief, and the LTT rates are shown in the below figure.

Figure 2 – Average tax main residential rates of LTT and SDLT with first-time buyers relief



Source: Welsh Government estimates based on HMRC administrative datasets

6.15 It is estimated that there are around 17,000 first-time buyer transactions in Wales – this represents less than a third of all residential transactions. The latest average first-time buyer price in Wales is £132,074 (ONS December 2017). There is limited information available about first-time buyers in Wales, however, it is estimated around 13,000 transactions or 80% of first time buyers in Wales buy homes costing below £180,000.

6.16 As the LTT threshold will be £180,000, the introduction of LTT will have no effect on first-time buyers up to this price - they will continue to pay no tax. From £180,000, first-time buyers in Wales will pay more tax compared to stamp duty land tax. This will affect around 4,000 transactions or the 20% highest priced first-time buyer purchases in Wales.

Higher rates residential property transactions

6.17 The higher rates for stamp duty land tax were introduced in April 2016. Therefore there is currently limited evidence about the effect of the higher rates in Wales. These rates most commonly apply to those acquiring buy-to-let properties and second homes. It is estimated there are around 14,000 of these transactions (around a quarter of the total residential market in Wales) in 2018-19.

6.18 LTT for higher rates residential property transactions (for example, buy-to-let and second home properties) will be 3% on top of the prevailing main residential rates, the same as stamp duty land tax. Overall, the differences between LTT and stamp duty land tax main rates are unlikely to create any significant changes in behaviour for higher rates residential property transactions.

- 6.19 The effective continuation of the higher rates from stamp duty land tax will mean those who purchase a property, which is not a higher rates residential property transaction, will continue to pay less tax and therefore be at an advantage over other buyers. The introduction of LTT should not have any additional impact on the markets for buy-to-let properties and second homes.
- 6.20 The total tax paid on additional residential properties will be different to that paid under stamp duty land tax. The tax on additional residential properties, through the higher rates, is effectively 3% on top of the main rates of LTT, which are different to stamp duty land tax. This will have similar implications relative to stamp duty land tax in terms of where more or less tax is paid following the introduction of LTT as for the main rates described above. In summary:
- For additional residential property transactions up to £125,000, LTT and stamp duty land tax will be the same;
 - For additional residential property transactions between £125,000 and around £400,000, LTT will be less than stamp duty land tax;
 - For transactions from around £400,000, LTT will be higher than stamp duty land tax; and
 - Consistent with stamp duty land tax, the difference in tax between those paying the higher rates on additional property transactions and those paying the main rates will be 3% of the property price.

Behavioural and wider economic effects

6.21 Changes in tax rates are expected to affect both prices and transactions. The impacts on these will be to alter them in the opposite direction to the change in the tax liability. These effects are difficult to quantify and are generally graded with a 'high' uncertainty rating by the Office for Budget Responsibility³. The general effects of these are described below.

Price effects

6.22 For non-first-time buyer transactions between £125,000 and £250,000, the tax will be reduced or removed altogether through the introduction of LTT, unless the transaction is undertaken by a first-time buyer. For these transactions prices may rise. However, this is unlikely to be a large effect given the size of the tax reduction. This price rise will benefit most existing property owners where the tax is reduced.

6.23 However, for those purchasing through a mortgage (assumed to apply to most transactions) the price rise together with the tax decrease is likely to result in a lower upfront cost. Whilst there will be slightly higher costs for future mortgage repayments, there will also be the additional benefit of owning a more expensive asset, which can be sold in the future.

6.24 The effect on prices is reversed where the tax increases; lowering prices where this applies. This will generally be for those purchasing properties for more than £400,000. It will also apply to first-time buyer purchases above £180,000, but with a more modest effect as the tax change is generally lower here.

Transaction effects

6.25 Overall the introduction of LTT will slightly increase the number of residential transactions. With transactions - like the price effect - the effect will work in the opposite direction to the change in tax. For non-first-time buyer transactions between £125,000 and £250,000, more transactions may occur through the reduction in tax. On the other hand, for properties over £400,000, it is estimated that there may be fewer transactions as a result of introducing LTT. For first-time buyers, tax will increase following the introduction of LTT rates for transactions above £180,000. Ordinarily this would be associated with a decrease in transactions for these transactions in this price band. However, with LTT now being

³ See OBR (December 2017) available at: <http://budgetresponsibility.org.uk/download/policy-measures-database/>

liable, this effectively ends the stamp duty land tax first-time buyer policy at these higher prices in Wales. The OBR's assessment of the stamp duty land tax relief is it has a very limited effect on increasing the number of first-time buyer transactions⁴. Following this assessment of the evidence, it is assumed that the tax increase on first-time buyers in Wales from £180,000 is unlikely to have much effect on the number of transactions.

6.26 As a far greater number of transactions will be subject to a tax decrease than a tax increase, overall, the introduction of LTT is likely to lead to an increase in residential transactions. As transactions are considered to have positive economic effects, an overall increase may improve economic welfare. The potential benefits from trade are normally experienced by both buyers and sellers, and therefore both would gain from an increase in the number of transactions. It is not possible to estimate what the size of these gains would be for each household. However, this is likely to result in a more efficient allocation of housing more generally across households, as transactions allow houses to be acquired by those who value them more. In addition, another potential secondary effect could be to increase consumer spending in Wales. Evidence suggests increasing house transactions can increase consumer spending through the ancillary spending required when moving house, which does not 'crowd-out' other forms of spending⁵. This in turn will have a positive effect on economic growth. However, given the relatively modest effect on transactions overall, these secondary effects are unlikely to be significant.

Forestalling

6.27 A further potential transaction behavioural effect is forestalling. This is when the timing of transactions is altered in order to reduce the tax liability. As the LTT rates have been announced ahead of 1 April 2018, this has provided the opportunity for transactions to either be delayed or brought forward, depending on which tax regime would provide the lowest tax liability.

6.28 Forestalling benefits those undertaking the transaction by reducing their tax liability. Therefore there are potential gains for those towards the lower end of the house price distribution if transactions were delayed until April 2018 and for those towards the higher end of the house price distribution if transactions were brought forward into stamp duty land tax ahead of April 2018. These changes in tax are the same as those described above more generally.

6.29 The forestalling effect is temporary and most likely in the immediate months before and after April 2018. Forestalling will have limited effects on economic welfare, as it results in the timing of transactions being altered, rather than whether the transaction occurs. There could be some disruption caused in the property market if the timing of large numbers of transactions were altered, but as the tax changes from stamp duty land tax to LTT are relatively modest overall, this is not expected to occur.

6.30 Forestalling will affect the tax revenues received by the Welsh Government and the UK Government. In aggregate it is expected that the UK Government will receive extra revenues as a result of the introduction of LTT and the Welsh Government less. However, under the terms of the Fiscal Framework agreed between the UK Government and the Welsh Government, the Welsh Government expects to be reimbursed for forestalling behaviour and the Welsh Government's revenue forecast therefore includes the UK Government's additional revenues.

6.31 Overall revenue generated from the residential rates, including the total behavioural effects in 2018-19 is £163m.

⁴ See OBR (November 2017) available at: <http://budgetresponsibility.org.uk/download/economic-and-fiscal-outlook-november-2017/>

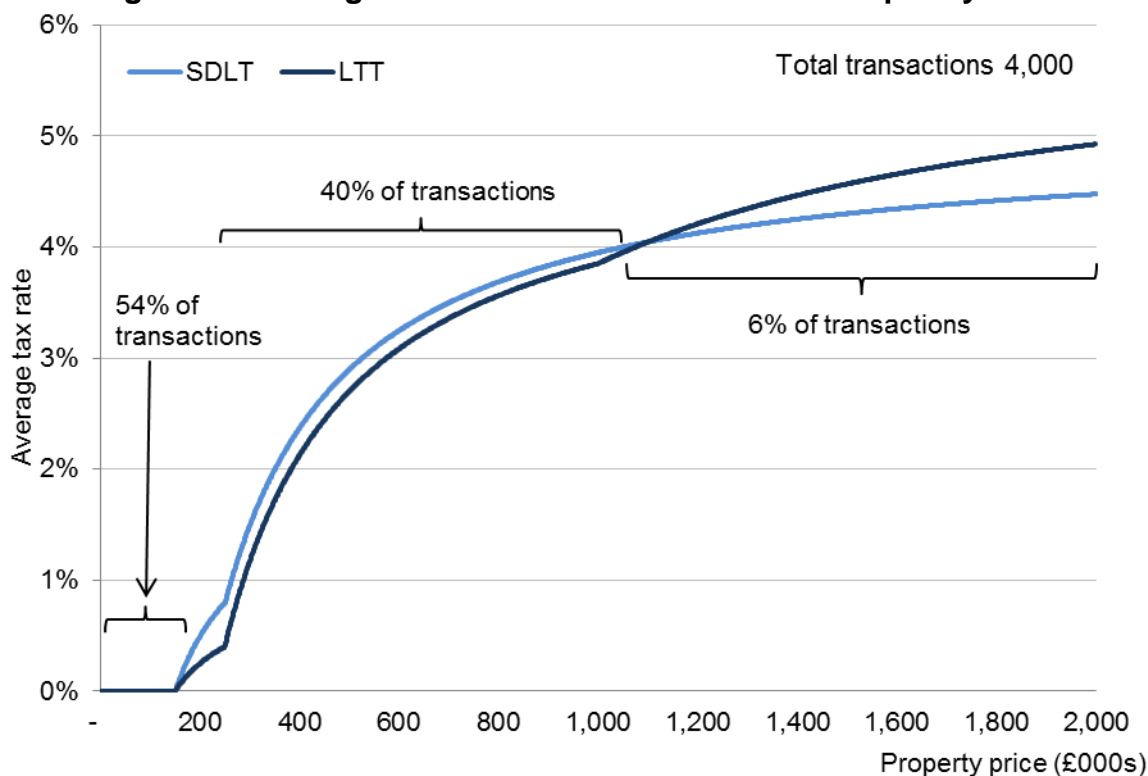
⁵ See *Housing Market Responses to Transaction Taxes: Evidence From Notches and Stimulus in the UK* by Michael Best and Henrik Kleven, forthcoming in *Review of Economic Studies*.

6.1 Further information on the forecast is available in Bangor Business School's scrutiny and assessment update report published alongside the final Budget 2018-19⁶.

Non-residential

6.2 The LTT non-residential rates are compared to the equivalent stamp duty land tax rates in the chart below. The chart shows the average tax rate as this allows the effect of the different tax rates and thresholds to be reflected.

Figure 3 – Average tax rates of non-residential stamp duty land tax and LTT



Source: Welsh Government estimates based on HMRC administrative datasets

NB Distribution is based on non-residential transactions which are not relieved of tax.

6.3 In total, it is estimated that there will be just over 4,000 non-residential transactions in Wales in 2018-19 which are not relieved and are potentially subject to the main rates. However, not all of these will be affected by the introduction of LTT. With LTT, like stamp duty land tax, no tax is paid on non-residential freehold, assignment transfers or leasehold premium transactions under £150,000. It is estimated around half of all taxable non-residential transactions in Wales will be below the £150,000 threshold in 2018-19. Therefore these transactions will not be affected by the introduction of LTT rates.

6.4 As LTT starts with a lower tax rate (1%) relative to stamp duty land tax (2%), all transactions from £150,000 up to £1.1m will pay less tax – by up to £1,000. It is estimated around 40% of taxable transactions in Wales are in this price range and will pay less under LTT than with stamp duty land tax.

⁶ Final Budget 2018-19 available at; <http://gov.wales/funding/budget/final-budget-2018-19/?lang=en>

6.5 From £1.1m, LTT will be higher than stamp duty land tax. In 2018-19, it is estimated that less than 300 (or around 6%) of non-residential transactions in Wales will pay more tax compared to stamp duty land tax. The increase in tax will vary depending on the value of the transaction. A £2m transaction will have a tax liability of £89,450 under stamp duty land tax and £98,440 under LTT. A £5m transaction would see its tax liability rise from £239,500 under stamp duty land tax to £278,500 under LTT.

Behavioural and wider economic effects

- 6.6 As with changes to the residential tax rates, increases in tax rates from stamp duty land tax to LTT will reduce both prices and the number of non-residential transactions, or vice versa where tax rates decrease.
- 6.7 For transactions where there is a tax decrease from stamp duty land tax to LTT (between £150,000 and £1.1m) both the price and number of these transactions will increase. However, the estimated effects are likely to be small for both prices and transactions given the size of the tax change.
- 6.8 For transactions where there is an increase in tax (above £1.1m), the price and transactions effects work in the opposite direction, reducing prices and the frequency of transactions. However, there are far fewer transactions which will have an increase in tax compared to those which will see a decrease.
- 6.9 As with the residential rates, the introduction of LTT will slightly increase the overall number of non-residential transactions. As transactions are considered to have positive economic effects, this may also indirectly improve welfare. As this increase relates to businesses, it may also increase efficiency and productivity. The potential benefits from trade are normally experienced by both buyers and sellers, and therefore both would gain from an increase in the number of transactions. It is not possible to estimate what size these gains will be for businesses. However, this is likely to result in a more efficient use of business premises more generally.
- 6.10 It is assumed that smaller businesses may benefit more from the reduction in tax, as they are more likely to purchase buildings between £150,000 and £1.1m. The cost (and potentially the size) of a building is likely to loosely correspond to the size of the business overall, therefore some relatively large businesses may also benefit from the reduction in tax through the introduction of LTT.
- 6.11 The introduction of LTT will mean tax increases for non-residential properties purchased for over £1.1m. These purchases are considered to be less likely to involve smaller or medium sized businesses, so larger businesses are much more likely to be affected by the tax changes in this price range.
- 6.12 Secondary effects from these tax changes could possibly impact on smaller businesses through a reduction in large value transactions. This might result in reduced investment in business premises which could then be sub-let to smaller businesses, affecting the supply of new business premises. There is unlikely to be much effect on the current supply of businesses premises in the short to medium term, but there could be a longer run impact if fewer premises are brought into supply over time. However, the size of the possible secondary effects is estimated to be low as prices are also assumed to adjust from the increase in tax.
- 6.13 As with the residential rates, there is expected to be some forestalling as a result of announcing the rates and bands ahead of April 2018. This form of behavioural change is expected to be limited to 2018-19. Forestalling benefits those undertaking the transaction by reducing their tax liability. Therefore there are potential gains to those transacting between £150,000 and £1.1m if they are delayed until after the introduction of LTT and for those purchasing at prices over £1.1m if they are brought-forward into stamp duty land tax. Some administrative forestalling is also expected to take place where transactions are brought forward to use the familiar HMRC administration system. However, the negative

impact on revenues is expected to be neutral in budgetary terms as it is expected the UK Government will reimburse the Welsh Government with the extra revenues it receives in 2017-18 as a result of forestalling under the terms of the Fiscal Framework.

Non-residential lease rent rates

- 6.14 In total, there are estimated to be around 2,000 non-residential transactions in Wales in 2018-19 which are not relieved and are potentially subject to the lease rent non-residential LTT rates. However, not all of these will be affected by the introduction of LTT. Broadly, like stamp duty land tax, no tax will be paid on transactions below £150,000. It is estimated in 2018-19 that just under 1,000 (or around half of) transactions will be below £150,000. These transactions will be unaffected by the introduction of LTT rates. Between £150,000 and £2m, the tax liability is the same for LTT and stamp duty land tax, so there will be no impact from the introduction of the LTT rates and bands for transactions within this price band⁷.
- 6.15 For transactions above £2m, LTT may be higher than stamp duty land tax by up to £30,000. It is estimated there will be fewer than 100 (or less than 5% of) transactions in Wales with an NPV of £2m or more in 2018-19 where more tax will be payable with the introduction of LTT. For these transactions, there is expected to be negative effects on transactions and prices, or the net present value in this instance. As the value is a combination of the annual rent and the length of the lease, a downward effect on prices could result in shorter very high value leases, a decrease to some high value annual rents or a combination of the two. However, as the increase in tax affects very few high value transactions and the increase in tax is modest, overall there is unlikely to be any significant effect on prices or transactions in this price band. All other behavioural effects and possible wider economic impacts as a result of LTT on non-residential lease rents are also considered to be negligible.
- 6.16 Overall revenue generated from the non-residential rates, including the total behavioural effects in 2018-19 is forecast to be £86m.
- 6.17 Further information on the forecast is available in Bangor Business School's scrutiny and assessment update report published alongside the final Budget 2018-19⁸.

The figures may not exactly reproduce HMRC aggregates. The use of HMRC statistical data in this work does not imply the endorsement of HMRC in relation to the interpretation or analysis of the information.

7. Post Implementation review

- 7.1 Section 77 of the LTT Act provides that the Welsh Ministers must make arrangements for an independent review of land transaction tax to be completed within 6 years of the day after the day of the LTT Act receiving Royal Assent. A review of LTT will encompass all of the subordinate legislation made under the LTTA Act.

⁷ There are targeted anti-avoidance rules that apply to some non-residential rental payments which may apply to non-residential lease rent transactions which may increase the tax. However, that is not a result of the introduction of these rates and bands. The impact of the targeted anti-avoidance rules is set out more fully in the Explanatory Memorandum that accompanies The Land Transaction Tax (Specified Amount of Relevant Rent) (Wales) Regulations 2018.

⁸ Final Budget 2018-19 available at; <http://gov.wales/funding/budget/final-budget-2018-19/?lang=en>