22 January 2015

DEVOLED TAXES – RATES AND BANDS

Further to the announcement which I made in Parliament yesterday, I am writing to provide you with further details on my planned rates and bands for Land and Buildings Transaction Tax and Scottish Landfill Tax from April 2015.

Land and Buildings Transaction Tax (LBTT) – Residential transactions

I confirmed to Parliament yesterday that I have reviewed the proposed LBTT rates and bands for residential transactions in order to ensure that I remain true to the principles which underlined the original proposals announced in the 2015-16 Draft Budget following the changes made to UK Stamp Duty Land Tax (SDLT) in December 2014.

I therefore intend to bring forward an Order to set residential rates and bands as follows:

<table>
<thead>
<tr>
<th>Purchase price</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to £145,000</td>
<td>-</td>
</tr>
<tr>
<td>£145,001 to £250,000</td>
<td>2.0%</td>
</tr>
<tr>
<td>£250,001 to £325,000</td>
<td>5.0%</td>
</tr>
<tr>
<td>£325,001 to £750,000</td>
<td>10.0%</td>
</tr>
<tr>
<td>£750,001 and over</td>
<td>12.0%</td>
</tr>
</tbody>
</table>

My decisions have again been influenced by the four maxims set out by Adam Smith, particularly that taxes should be proportionate to the ability to pay. These revised rates and bands prioritise support for first time buyers and are intended to assist people moving through the property market.
The nil rate threshold for the tax will be set at £145,000 - £10,000 higher than originally announced, which will result in an additional 5,000 transactions being taken out of the scope of taxation compared to the October proposals so that in total 10,000 fewer transactions will be taxable in Scotland under LBTT than would have been taxed under SDLT.

I have introduced a new marginal rate of 5% to apply between £250,001 and £325,000 which will ensure that over 90% of transactions continue to be better or no worse off under LBTT compared to UK SDLT, as was the case at the time of the Draft Budget. As a result, those people purchasing a property for £330,000 or less will pay less tax under LBTT than they would have under UK SDLT.

In order to ensure that we can provide benefits for those entering and progressing through the housing market and to ensure that the tax charge remains proportionate to the ability to pay, the top marginal rate of 12% will now apply to transaction values above £750,000. As a result the purchase of a house for more than £945,000 will attract a higher LBTT charge than originally proposed in October. This means that the tax charge on 99.9% of all transactions will either be lower than under the original proposals or will be nil.

I consider that these revised rates and bands demonstrate very clearly that the Scottish Government has placed fairness, equity and the ability to pay at the very heart of the decisions we have taken on national taxes.

Rate-setting Orders

The rates and bands announced yesterday, and those announced in October, of course remain subject to Parliamentary scrutiny and approval. I will bring forward Orders to set rates of Land and Buildings Transaction Tax and Scottish Landfill Tax in early February.

I can confirm that the Order setting rates and bands for residential transactions for Land and Buildings Transaction Tax will also include the rates and bands for non-residential and lease transactions that I announced in October. A separate Order concerning Scottish Landfill Tax will include the standard rate and lower rate as announced then.

Forecast tax revenues

I have prepared an updated forecast of the revenue which I expect to raise from residential LBTT. I estimate that these revised rates and bands would generate £235 million in 2015-16 (full year forecast). This forecast has been scrutinised by the Scottish Fiscal Commission, which considers this forecast to be a consistent application of the forecasting methodology which they reported on and viewed as reasonable in October 2014. I have placed the letter received from the Scottish Fiscal Commission in SPICe and attached a copy as an annex to this letter.

The Finance Committee recommended in its recent report on the Draft Budget that the Scottish Government should in future provide a breakdown of the expected receipts for each band of residential LBTT. The table below provides a breakdown of the revenue generated by each of the bands announced yesterday.
<table>
<thead>
<tr>
<th>Band</th>
<th>Revenue by Rate £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to £145,000</td>
<td>-</td>
</tr>
<tr>
<td>£145,001 to £250,000</td>
<td>110.1</td>
</tr>
<tr>
<td>£250,001 to £325,000</td>
<td>65.2</td>
</tr>
<tr>
<td>£325,001 to £750,000</td>
<td>58.4</td>
</tr>
<tr>
<td>£750,001 and over</td>
<td>1.3</td>
</tr>
</tbody>
</table>

As this is the first year of LBTT and there are significant differences in the tax charge between LBTT and the UK tax which it replaces, I also intend to make an adjustment to this forecast to reflect potential revenue losses to Scotland as a result of forestalling effects. As I noted in my letter to the Committee of 19 January, the UK reforms to SDLT at the Autumn Statement made it most likely that such behavioural responses would occur. The Scottish Fiscal Commission has begun its work to scrutinise the approach which we are taking to estimate the value of these forestalling effects, and I will provide a further update to the Committee when that work has concluded.

As you are aware, the impact of forestalling is also one of the technical issues still to be agreed with the UK Government as part of negotiations on the one-year block grant adjustment (BGA) for 2015-16.

I have assessed revenue neutrality for 2015-16 in terms of the headline one-year BGA agreed with the UK Government of £494 million, which as you know represents the mid-point of the Scottish Government and OBR forecasts of the aggregate tax revenues foregone by the UK Government. My 2015-16 tax revenue forecasts for non-residential LBTT and Scottish Landfill Tax remain unchanged from the Draft Budget – at £146 million and £117 million respectively. This leaves a remaining balance of £231 million to be raised from residential LBTT in 2015-16, before forestalling effects are taken into account. I considered it prudent to build some modest headroom into the pre-forestalling revenue to be generated by residential LBTT in order help manage the risk that the forestalling adjustment which the UK Government is prepared to agree to the BGA falls short of my assessment of the likely revenue losses to the Scottish Budget, as scrutinised by the Scottish Fiscal Commission. Should there be any remaining flexibility once forestalling effects have been agreed and calculated, I would intend to use this to make the first payment into the cash reserve at the end of 2015-16.

I trust that this information is helpful to the Committee. I will provide a formal response to the recommendations which the Committee made in its report on the Draft Budget ahead of the Stage 3 debate next month. In the meantime, I would be very happy to provide any further information on these tax rates and bands which would assist the Committee in its scrutiny of devolved taxes.
I have also copied this letter to finance spokespeople from the opposition parties.

Copy to: Jackie Baillie MSP
        Gavin Brown MSP
        Patrick Harvie MSP
        Willie Rennie MSP

JOHN SWINNEY
21st January, 2015

John Swinney MSP
Deputy First Minister and Cabinet Secretary
for Finance, Constitution and Economy
St Andrew's House
Regent Road
Edinburgh
EH1 3DG

Dear Minister,

Thank you for your letter which I received on 16th January, asking the Scottish Fiscal Commission (SFC) to scrutinise and provide a view on any revised forecasts the Scottish Government may produce in light of the changes to the SDTT announced in the UK Government's 2014 Autumn Statement.

The most recent top-line estimate of LBTT tax revenues follows the methodology described and accepted as reasonable in our October 2014 Report. We note that the annual model has not been updated in line with any new data that have emerged in the few months since the time of the original report.

Based on our understanding of that model, we believe the most recent top-line revenue forecasts, before forestalling is taken into consideration, are a consistent application of the new tax schedule to the forecasting methodology which, as stated above, we have viewed as reasonable.

The calculation of the forestalling effect is both desirable and relatively straightforward in itself. However, it depends upon identifying the elasticity of the transactions with respect to anticipated changes in the tax schedules, which is less straightforward.

We have engaged with your officials, reviewed early and later versions of their analysis, and asked them to provide further and sufficient evidence on the value of this elasticity in order to enable the SFC to form a view of the reasonableness of that calculation.

Our understanding is that they continue to refine this work. We appreciate that it is complex and requires judgment. We will review any further evidence they can provide in support of the assumptions underpinning their forestalling calculation as and when it becomes available.

We would also note that the forecasts do not incorporate any behavioural responses to changes in tax regime beyond the forestalling effects; limited evidence we have suggests that these are likely to be important as well.

Thank you for the opportunity to comment on the revised forecasts.

With all good wishes,

Susan Rice
Chairman