Land Buildings Transaction Tax – Year One

Comments by the Scottish Property Federation for the Finance Committee of the Scottish Parliament

Introduction

1. The Scottish Property Federation (SPF) is the voice for the property industry in Scotland and speaks for over 180 corporate members with interests in Scottish real estate. We include within our membership major institutional investors and funds, developers, real estate lenders, landlords of commercial and residential property, and professional property consultants and advisers.

2. We are happy for our comments to be published by the Scottish Parliament and to be shared with other public authorities.

Key Points

3. Our main points are:
   
   • In January 2016 the Scottish Government greatly increased its revenue forecasts from £381mn to £455mn mainly due to better than expected non-residential revenue. The outcome for LBTT revenue in 2015-16 was £414mn1 with residential revenue ending up some £39mn short of the Scottish Government’s January 2016 expectations.
   
   • Forestalling is suggested to have reduced revenue by around £20mn in the Committee's call for evidence – however, there was a marked spike in activity ahead of the April 2016 introduction of the 3% Additional Homes Supplement so this would have been positive for LBTT revenue in the 2015-16 year, thus dampening the overall impact of forestalling and loss of revenue ahead of the introduction of LBTT in April 2015.
   
   • The government should be wary of making significant adjustments in expectations at the new year mark – evidence over a number of years points to a lull in transactional activity in the final quarter of the year, for both the commercial and residential markets.
   
   • To reform residential rates and thresholds in 2017-18 by increasing the 5% band up to £500,000.
   
   • To make no change in the commercial rates and thresholds in 2017-18.
   
   • To make no change to non-residential lease LBTT in 2017-18 and to aid the scrutiny of the non-residential aspect of the tax we think it would be helpful if the Revenue Scotland data could differentiate between the amounts of LBTT paid upon sales and that which is paid for leases.
   
   • LBTT has been successfully introduced in administrative terms and is now an established tax – Revenue Scotland need to invest in awareness of its services and to prepare for the implementation of the rent reassessment process for non-residential leases.
General Comments

4. LBTT is now firmly established within the Scottish tax and regulatory systems. The markets are becoming accustomed to its operation and the tax could be said to have successfully ‘bedded in’ for the bulk of the property markets. The introduction of the progressive structure to the new tax has been well received and indeed since replicated for residential transactions in the rest of the UK. Some complications remain where property portfolios that straddle the UK and Scottish tax systems are transacted. This will be a permanent feature of the property markets to some extent as there continues to be policy innovation (for example the 3% Additional Dwellings Supplement) and divergence between the UK and Scottish administrations (for example the proposed SDLT Seeding Relief to support investment in Property Authorised Investment Funds).

5. In relation to the rates and thresholds we believe there are two clear stories that have emerged from the operation of LBTT in its first year. On residential property we believe there was a clear and immediate impact upon the residential markets where the transaction was for relatively higher values from £325,000 and above. We will explain our view that this has consequences for the residential markets and indeed government revenues. For the commercial markets where far less radical reform to the rates and thresholds was implemented we would argue that from the government’s perspective the new tax system has operated well. Indeed with the increase in commercial SDLT rates from March 2016 it is the Scottish Property Federation’s view that we are now in a marginally more favourable position relative to UK SDLT for the non-residential sector for LBTT on both sales and leases. In addition, we welcome and commend the decision to exempt large scale private rented sector transactions of six or more properties from the 3% additional home supplement. These measures can offer a positive differentiation to investors in UK real estate from the Scottish perspective and we recommend continuing this competitive distinction.

Impact on the residential market property markets of the various rates and thresholds

6. The most radical market impacts of LBTT came in the residential markets. Figures from the Registers of Scotland suggest that there has been an overall reduction in property transactions in the course of the first year of LBTT for transactions above £325,000. However, this was not uniform across all tiers of the market. One intention of the Scottish Government was to remove or reduce the cost of tax for a high proportion of purchasers from LBTT – this clearly was aimed at the lower levels of the markets and there is evidence of an increase in turnover below £325,000. Again, it is possible that some of these transactions may also have been prompted by the introduction of ADS in April 2016 as buy-to-let-investors sought to invest ahead of the new tax. There have been authoritative suggestions of a significant spike in residential property transactions in March 2016 across the UK.

7. For the higher value bands we believe there was a distinct reduction in transactions which only began to be reversed towards the latter part of the tax year. Indeed, we believe there continues to be evidence that suggests activity in the higher value bands remains subdued even now. This is hard to attribute as there could be many contributory factors (market confidence, impact of the slowdown in the Oil and Gas sector among the key issues) but if we compare the growth trend of LBTT and Scottish higher value transactions under SDLT before the introduction of LBTT with the value and number of higher value transactions since then we estimate a loss of some £200mn in value and 235 in number of transactions at the £325,000 plus
level. Based on evidence from members, we believe the bulk of this slowdown comes in the £500,000 plus range.\[8]

8. In the years prior to the introduction of LBTT the value of property transactions at above £325,000 had grown in Scotland by over £1.5bn before reversing in value during the first year of LBTT by £200mn (see top Chart and the Table on p4). We cannot perceive any other major factor for this reversal other than the application of the higher bands of LBTT and we believe this has wider implications for the functioning of the markets. Specifically, Lower numbers of tax-paying transactions will clearly impact on government revenues but it will also undermine market fluidity as householders wishing to upsize or downsize struggle to find purchasers. Thus changes to tax rates have an impact not just directly on purchasers in that particular element of the market but also upon those aspiring to purchase a family sized house or perhaps to reduce the number of bedrooms they look after. The market is a continuum and changes in one part of the market will filter outwards to impact on other levels of housing activity.
Land Buildings Transaction Tax – Year One

Total Annual Residential Property Transaction Values at LBTT Bands (2012-2016)

Residential Property Transactions in Scotland by LBTT Bands (2012 -2016)

<table>
<thead>
<tr>
<th>Year</th>
<th>Up to £145000</th>
<th>£145001 to £250000</th>
<th>£250001 to £325000</th>
<th>£325001 to £750000</th>
<th>Over £750000</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/13</td>
<td>42688</td>
<td>21565</td>
<td>4080</td>
<td>4517</td>
<td>231</td>
</tr>
<tr>
<td>2013/14</td>
<td>49685</td>
<td>26544</td>
<td>5249</td>
<td>5823</td>
<td>409</td>
</tr>
<tr>
<td>2014/15</td>
<td>49731</td>
<td>29035</td>
<td>6427</td>
<td>7555</td>
<td>532</td>
</tr>
<tr>
<td>2015/16</td>
<td>52574</td>
<td>31199</td>
<td>8471</td>
<td>7390</td>
<td>462</td>
</tr>
<tr>
<td>2016 Q1</td>
<td>13691</td>
<td>8085</td>
<td>2062</td>
<td>1991</td>
<td>123</td>
</tr>
</tbody>
</table>
The commercial property market took longer to recover from the financial crash and recession of 2007-08. However, recent evidence suggested the recovery has been steady since 2012. Currently, Scottish commercial property transactions are at an overall value of £3.5bn per year, compared to some £6.3bn at the height of the market in 2006-07. The number of commercial property transactions taking place annually too had steadily increased. Clearly the rates and thresholds introduced under LBTT were less radical a change from SDLT than those imposed on the residential sector and we believe this has supported a smoother transition from SDLT to LBTT for the commercial sector.
10. In terms of the numbers of commercial property transactions the charts show there has been little change since the introduction of LBTT and this has supported a consistent, if steady recovery, in the commercial markets since the financial crash. This supports the idea that the closer alignment of the LBTT rates and thresholds with the previous SDLT rates has avoided significant disruption to the commercial markets.

11. Non-residential lease transactions also pay LBTT where eligible (where the Net Present value of the lease is above £150,000). Revenue Scotland do not published figures that specify the amount of lease duty collected per month but the evidence of Scottish Government statistics at the time of the LBTT Bill suggested that there could be a significant amount of tax involved. To aid the scrutiny of the tax we think it would be helpful if the Revenue Scotland data could differentiate between the amounts of LBTT paid upon sales and that which is paid for leases. In administrative terms we believe that this should be feasible as the lessee enters a separate tax return when taking a lease and this ought to be easily identifiable for the purposes of data collection.

Forestalling

12. One of the key questions surrounding revenue flows for LBTT has been the extent of forestalling that could be attributed to purchasers bringing forward transactions in order to pay under SDLT rates as opposed to LBTT. The call for evidence suggests that some £20m in ‘lost’ revenue might be attributed to this process. However, there was also revenue positive ‘forestalling’ towards the end of the year and arguably at much greater levels of activity whereby purchasers moved to avoid paying the 3% additional dwellings supplement charge. This would have impacted property transactions at lower price levels, as the ‘second home’ need only be worth above £40,000 in order to attract the 3% surcharge.

Receipts v. forecasts

13. The Scottish Government will have been pleased to see its original forecasts for LBTT revenue achieved if both commercial and residential LBTT is aggregated. The total revenue of LBTT is in many senses the bottom line for the government. However, in January and as part of the overall Scottish Budget passed for 2016 the then Finance Secretary had increased his expectations considerably. This new much higher figure was not achieved and this was because of lower than forecast residential LBTT. Indeed, even based upon the original lower forecasts of LBTT revenue, the 2015-16 residential LBTT revenue is lower than forecast as illustrated below under paragraph 14.
14. In contrast to the residential sector, commercial LBTT performed much more strongly than anticipated by either ourselves or the government’s original estimates. This supports our view that the rates and thresholds were less radical and better constituted for the commercial sector and, if we compare the receipts and forecasts with the previous year of SDLT then it becomes clear that there was a significant drop in residential receipts during 2015-16.

<table>
<thead>
<tr>
<th></th>
<th>Full year 15/16 totals (£m)</th>
<th>Original forecasts (£m)</th>
<th>Revised forecasts (£m)</th>
<th>SDLT 14/15 (£m)</th>
<th>Source:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>202</td>
<td>235</td>
<td>245</td>
<td>270</td>
<td></td>
</tr>
<tr>
<td>Commercial</td>
<td>214</td>
<td>146</td>
<td>210</td>
<td>205</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>416</td>
<td>381</td>
<td>455</td>
<td>475</td>
<td></td>
</tr>
</tbody>
</table>

**Changes to rates and thresholds for Budget 2017-18**

**Residential sector**

15. We believe that the 5% band between £250,001 and £325,000 remains too narrow and does not serve the market or indeed government revenues well as it stands. The application of a 10% rate of LBTT for the value a transaction above £325,001 is effectively adding £500 for every £5,000 of property value above this level. This causes significant impact on the market at the higher levels where you begin to pay in excess of £23,500 from £500,000 - significantly increasing ‘up-front’ cash-flow issues. This reduces activity at this level which in turn reduces the opportunity for households to move up the property ladder. In areas such as Edinburgh, Aberdeen or East Renfrewshire a detached house will easily become subject to these higher charges.

16. We have just one full quarter’s LBTT and transactional data for this financial year to date. Overall the revenue appears to be on course for an improvement in the second year of LBTT. However, a significant proportion of this improvement is attributable to the 3% ADS charge which is worth some £16mn of the £110mn so far collected by Revenue Scotland. Some of this charge might be attributable to ‘accidental’ second homeowners through the conveyancing system and may be eligible for repayment. Experts within
Land Buildings Transaction Tax – Year One

our industry have also suggested that some mainly commercial transactions albeit with a small residential element could also be subject to the tax. However, at this stage the main conclusion is that ADS has easily surpassed government expectations in terms of revenue.

<table>
<thead>
<tr>
<th></th>
<th>Residential (£m)</th>
<th>Commercial (£m)</th>
<th>Total (£m)</th>
<th>ADS (£m of total figure)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016/17 – April-June</td>
<td>65.5</td>
<td>44.6</td>
<td>110.1</td>
<td>16.4</td>
</tr>
</tbody>
</table>

17. Of greater concern is that fact that the residential sector, without ADS, would continue to lag behind its commercial equivalent in terms of revenue. Historically the residential market which is several times larger than its commercial equivalent with much greater frequency of transactional activity, would have raised significantly greater revenue. The last year of SDLT relevant to Scotland illustrates this point with respective differences of £275mn to £202mn. This suggests to us that there is a significant reduction in LBTT revenue that will has flowed from residential LBTT hitherto and that there is also an opportunity cost in revenue terms for the government that is being missed as high value transactions fall to grow at the predicted rate thus losing potential revenue for the government as well as inhibiting the markets.

Non-residential

18. The picture is quite different in the commercial sector. The changes to UK commercial SDLT rates for sales and higher value leases now place Scotland in a favourable position vis-à-vis the rest of the UK. With revenue outstripping the last year of SDLT receipts and Scottish Government expectations it would appear that the rates and thresholds are supporting both competitiveness and the public revenue. We recommend that the commercial rates and thresholds remain as they are for 2016-17 and that the associated charge for non-residential leases also remains at 1%.

Revenue Scotland and administration

19. The administration of the tax appears, overall to be running efficiently. We are aware anecdotaly of concerns around the ability of professional advisers to obtain detailed guidance on more complicated transactions but we are also understand that Revenue Scotland are also seeking support to raise awareness of their services for property professionals as well. The introduction of the 3% supplement will have added complexity to the residential market and we will await with interest the outcome of its first year of operation. Equally we are not aware as yet of any plans for the introduction of the three yearly non-residential lease reassessments. We are concerned this could prove to be a significant administrative challenge to Revenue Scotland. The UK equivalent measure under SDLT has long since been abandoned and our understanding is that it proved fruitless in terms of capturing further revenue from the perspective of the government.
20. We would be pleased to answer any further questions or to provide further evidence at the Committee’s discretion.

\[\text{Footnotes:}
\]

1 Unlike the Scottish Government GERs report we do not attribute £10mn of ATED (Annualised Tax on enveloped Dwellings) to LBTT
2 Based on market information kindly supplied by Rettie & Co.