

Explanatory Memorandum to The Land Transaction Tax (Temporary Variation of Rates and Bands for Residential Property Transactions) (Wales) Regulations 2020

This Explanatory Memorandum has been prepared by the Permanent Secretary's Group of the Welsh Government and is laid before the Welsh Parliament 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 (Temporary Variation of Rates and Bands for Residential Property Transactions) (Wales) Regulations 2020. I am satisfied that the benefits justify the likely costs. This is a temporary change to commence 27 July 2020 and end on 31 March 2021, with the rates and bands reverting back to those currently in force after that date.

Rebecca Evans MS
Minister for Finance and Trefnydd

24 July 2020

1. Description

- 1.1 The purpose of this instrument is to specify a temporary variation to the land transaction tax ("LTT") rates and bands that will apply to purchases of certain residential property transactions.

2. Matters of special interest to the Legislative, 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 takes place before 1 April 2021, 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. The transitional rule made under section 78(1) does not have the effect described in section 79(3) on the basis that it reduces the amount of tax that will otherwise be chargeable on those specified transactions. However, as a result of section 40 of the Legislation (Wales) Act 2019, this instrument is subject to the provisional affirmative procedure.

3. Legislative background

- 3.1 Section 24 of 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 apply and any taxpayer who has underpaid, because they paid based on the now failed regulations, will not be pursued to make good that underpayment. 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 Monday 14 September and the vote to approve the Regulations must occur by 11 October.
- 3.4 The regulations have temporary effect until 31 March 2021.

4. Purpose & intended effect of the legislation

- 4.1 The purpose of these regulations is to make a temporary variation to the tax bands and percentage tax rates of LTT applicable to certain residential property transactions with an effective date¹ on or after 27 July 2020 and before 1 April 2021, as announced by the Minister for Finance and Trefnydd on 14 July 2020. This will be used to calculate the amount of LTT chargeable in respect of a residential land transaction and is restricted to those paying the main rates only. The tax bands and percentage tax rates applicable to residential property transactions will revert back to those in force before 27 July 2020 on 1 April 2021. The date these changes are to come into force, 27 July 2020, was chosen to coincide with the anticipated full re-opening of the housing market, announced by the First Minister on 10 July².
- 4.2 The effect of these Regulations is to increase the threshold between the zero rate band and first tax band applicable to residential property transactions. Currently, this is set at £180,000, but, as a result of these Regulations, will increase to £250,000 from 27 July. This new threshold is £70,000 higher than the current starting threshold for residential property transactions subject to the main rates and it will effectively remove the former first band, charging 3.5% on consideration of more than £180,000 but not more than £250,000. It will also mean that in terms of price, only around the top 20% of those liable to the main LTT rates will pay any tax at all. Those buying properties costing more than £250,000 will make a saving of £2,450 over that which would previously have been payable.
- 4.3 These Regulations do not make any changes to the tax bands and percentage tax rates applicable to higher rates residential property transactions, non-residential property transactions, or transactions where the chargeable consideration consists of rent³. The higher rates and thresholds for buyers of properties such as buy to let or as a second home therefore remain unchanged. This targeted tax reduction will support taxpayers who are paying the main rates of land transaction tax (broadly, those buying their homes) and who may need additional support in deciding to buy their homes as a result of the uncertainty as we move from the peak of the pandemic and towards our economic recovery.

¹ The 'effective date' is, broadly, the date of completion of the contract to purchase the property.

² <https://gov.wales/written-statement-review-health-protection-coronavirus-restrictions-wales-regulations-2020>

³ 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 higher rates residential property transactions, non-residential property transactions, and transactions where chargeable consideration consists of rent.

4.4 The LTT residential property main rates will, for transactions completed on or after 27 July 2020 until 31 March 2021, temporarily be:

Table 1: Residential Property Transactions - Rates and Bands from 27 July 2020 until 31 March 2021

Main rates Residential property transactions		
<u><i>Tax band</i></u>	<u><i>Relevant consideration</i></u>	<u><i>Percentage tax rate</i></u>
Zero rate band	Not more than £250,000	0%
First tax band	More than £250,000 but not more than £400,000	5%
Second tax band	More than £400,000 but not more than £750,000	7.5%
Third tax band	More than £750,000 but not more than £1,500,000	10%
Fourth tax band	More than £1,500,000	12%

5. Consultation

5.1 There is no statutory requirement to consult on this instrument. The increase to the nil rate band was announced by the Minister for Finance and Trefnydd on 14 July 2020. The timing takes account of calls from certain stakeholders and taxpayers for amended rates and bands to be introduced. However, the setting of rates and thresholds for taxes is not an area of policy where consultation is 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. The intention is to provide a temporary economic stimulus to support the housing market and broader economy in Wales. The temporary rates will come into force on 27 July 2020, in line with the anticipated removal of the restrictions on viewing occupied residential property for sale imposed due to the coronavirus pandemic.

6. Regulatory Impact Assessment

6.1 The revenue impact of these changes will be provided alongside the next Welsh Government draft Budget. The costing of the policy will be agreed with the Office for

Budget Responsibility and included as part of its forecast of land transaction tax (LTT) revenues for the Welsh Government.

- 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.

No change

- 6.3 The no change option would have left all rates and thresholds for the taxes as they have been since 1 April 2018 when land transaction tax first applied in Wales. These rates and thresholds mean that, in relation to the main residential rates, 60% of homebuyers do not pay any tax when buying their home, including the vast majority of first time buyers.
- 6.4 Following the temporary increase to £500,000 for the threshold for stamp duty land tax introduced from 8 July 2020, not changing LTT would result in some relatively large differences in tax between England and Wales. This is particularly so for very high priced property in Wales. This may affect some local property markets which straddle the England and Wales border, creating some market distortion in those areas. Around 20% of properties in Wales sell for £250,000 or more, at that price the difference in tax between SDLT and LTT would be £2,450. Around 10% sell for £300,000 or more, at that price the difference in tax would be around £5,000. Around 5% sell for £380,000 or more, at that price the difference in tax would be around £9,000. Around 1% sell for £600,000 or more, at that price the difference in tax would be around £20,000.

Temporary £250,000 threshold applied only to the main rates

- 6.5 This option is a time limited increase to the residential main rate threshold from £180,000 to £250,000. This change will, broadly, not apply to transactions where the purchaser already owns a residential property.
- 6.6 As a result of this change around 80% of Welsh homebuyers will pay no tax, up from 60% previously. For properties costing £250,000 or more, representing the top 20% of homebuyers, there will be a tax reduction of £2,450. This tax reduction is proportionately smaller for the highest price properties and largest for those priced at £250,000. The purchase of a home costing £200,000 will see a tax saving of £700, whereas one costing £240,000 will see a tax saving of £2,100.
- 6.7 This option does not provide a temporary tax reduction for those properties that are subject to the higher residential rates of land transaction tax. 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.
- 6.8 This option ensures the benefits of the tax savings are restricted to those with only an interest in the property they are acquiring (or who meet the replacement of a main residence rules) and not those purchasing buy to let properties, second or holiday homes. Purchasers who pay the higher residential rates account for around 25% of all residential purchases each year, although some of these may subsequently be refunded the higher residential rates and then be subject to the main residential rates.
- 6.9 Based on 2019-20 data, around 14,000 residential property transactions initially subject to the higher residential rates will not see any change to their tax as a result of restricting the threshold increase to the main rates.
- 6.10 Also, again based on 2019-20 data, this option will benefit around 16,000 transactions in Wales subject to the main rates of LTT. The number of transactions this year that will benefit from the tax reduction is difficult to estimate as the effect of the pandemic on the property market and the wider economy is highly uncertain. However, the tax reduction is expected to increase transactions overall, from that which would otherwise have occurred, and also prices. In addition, it is likely that some transactions will be brought forward from

2021-22 to take advantage of the temporary tax reduction. This forestalling effect should also increase the number of transactions in 2020-21⁴.

- 6.11 Following the temporary changes introduced to SDLT from 8 July 2020, the option to increase the LTT threshold on main rates to £250,000 will result in some relatively large tax differences in tax between England and Wales for some very high priced property in Wales. This may affect some local property markets which straddle the England-Wales border, creating some property market distortion in those areas.
- 6.12 With this option, around 80% of properties in Wales which are subject to the main rates will pay no tax. Only from £250,000 upwards will there be differences in tax between SDLT and LTT. Around 10% of properties sell for £300,000 or more, at that price the difference in tax between SDLT and LTT will be £2,500. Around 5% sell for £380,000 or more, at that price the difference in tax will be £6,500. Around 1% sell for £600,000 or more, at that price the difference in tax will be £17,500. This option reduces the difference in tax between SDLT and LTT compared to the no change option. It should therefore result in less local market distortion between England and Wales than the no change option.
- 6.13 This option, by not applying the temporary tax reduction to higher rate property transactions, 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.
- 6.14 Increasing residential property transactions in 2020-21, from that which would otherwise have occurred, is expected to have a positive effect on the housing market and the economy more generally this year. UK evidence during the economic downturn of 2008 to 2009 suggests reducing residential property transaction taxes boosted the property market and stimulated the economy⁵. Subsequent research for Wales suggests, whilst there may be positive benefits due to transactions being brought forward from future years, the overall benefit may be smaller than implied by the UK evidence⁶. However, the current economic downturn is very different to the one which occurred in 2008 and the tax system in Wales is also different (for example the shift from a slab to a slice system for residential property transactions occurred in 2014). It is therefore difficult to directly apply these studies to the current situation. Overall this option represents a more measured tax reduction in Wales compared to England, consistent with the differential economic effect suggested by the evidence.
- 6.15 The wellbeing of individuals and families who need to move may also be improved by this measure. This could be for a wide range of reasons, such as to be closer to family members who need care, for a new school, or a new job. This option is expected to generate additional transactions in 2020-21, from that which would otherwise have occurred, some of which will have been brought forward from 2021-22.
- 6.16 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 through SDLT and the introduction of LTT in Wales. This option will be limited to a single table of tax rates. There has been clear communication of the changes and the WRA has provided

⁴ For more details on forestalling see *Forestalling ahead of property tax changes* OBR (2016), available at https://obr.uk/docs/dlm_uploads/Working-paper-No.10-1.pdf

⁵ See Best, M. and Kleven, H. (2018) *Housing Market Responses to Transaction Taxes: Evidence from Notches and Stimulus in the UK*, The Review of Economic Studies, 85, pp. 157-193

⁶ See TARC (2019) *An Evaluation of the 2008-2009 Stamp Duty Holiday in Wales* available at https://tarc.exeter.ac.uk/media/universityofexeter/businessschool/documents/centres/tarc/publications/reports/An_Evaluation_of_the_2008-2009_Stamp_Duty_Holiday_in_Wales.pdf

a revised LTT calculator to establish liability. The additional costs to these businesses should therefore be minimal.

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.