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The Clerk
Finance Committee of the Scottish Parliament
EH99 1SP

Our ref: PS-2014 (25)
By email

Evidence by the Scottish Property Federation for the Finance Committee Inquiry into the Scottish Draft Budget 2015-16

1. Introduction

1.1. The Scottish Property Federation (SPF) is a voice for the property industry in Scotland. We include among our members; property investors including major institutional investors, lenders, developers, landlords of commercial and residential property, and professional property consultants and advisers.

1.2. We welcome this opportunity to provide evidence on the now announced proposals for rates and thresholds for the new Land and Buildings Transaction Tax. We understand our comments may be published and shared with other public authorities.

2. Key Points

We repeat our support for the replacement of the 'slab' structure of SDLT by the progressive approach to LBTT taxation.

We believe Scottish Ministers should have set a more prudent target for LBTT revenue in its first year that would have been equal to the average of Scottish SDLT raised in the past five years (2009-14).

A more prudent approach to LBTT revenue would have allowed Scottish Ministers greater freedom to set competitive tax rates and thresholds.

We are concerned at the higher value rates applied to residential property and we fear this will have a negative impact on those sections of the markets, with a potential knock-on consequence for those seeking to move up the property ladder.

We believe Scottish Ministers should have set the top commercial at 4% rather than 4.5% and we believe that the additional 0.5% will have a negative consequence for asset values and yields attributed to the commercial property investment market.

Key areas of LBTT policy of concern to our members remain to be determined including the consultations over development transactions and sub sale relief and; over multiple dwellings relief.

3. Background

3.1. The Scottish Budget announced on 9 October 2014 was historic in that it represented the first occasion in over 300 years when a Minister proposed a new tax setting budget to the Scottish Parliament. There are two new taxes, Scottish Land and Buildings Transaction Tax which will replace Stamp Duty Land Tax and the Scottish Landfill Tax which will replace its UK variant at the same time in Scotland from 1st April 2015. For the Scottish property industry LBTT is a key measure and one where we have engaged closely with the government and indeed this committee since the initial LBTT consultation paper in 2012.

3.2. The key feature of LBTT is that it abolishes the previous 'slab' approach of SDLT where a charge is levied upon the whole consideration of a transaction. Indeed, for commercial property sales where VAT is elected the charge is levied upon the consideration *and* the VAT applicable, thus earning the government double taxation. Unfortunately this double taxation has been replicated under LBTT.

3.3. However, returning to the structure of the tax, we welcome the move to a progressive tax system which is in line with other taxation approaches.

4. Revenue neutrality

4.1. A key issue with the move to LBTT was that a consequent reduction in the Scottish Block Grant from Westminster will be made which we understand is intended to be equivalent to the SDLT anticipated to be raised from Scotland for the 2015-16 financial year. There was considerable uncertainty over how this would be calculated. In his budget statement to Parliament we noted that the Finance Secretary stated:

> 'There is one outstanding factor in the devolution of taxation to the Parliament that I wish to raise. Despite repeated engagement with the UK Treasury, a final adjustment to the block grant has not yet been agreed.' (Official Report, Scottish Parliament, 9 October)

4.2. The UK Government has tasked the Office for Budget Responsibility with identifying future revenues from 'Scottish' SDLT including that which could have been expected without LBTT. The table below identifies these latest projections from March 2014.

Table 1: OBR Forecasts for Scottish SDLT 2012-17 (1st year of LBTT highlighted)

(All £mn)	2012-13	2013-14	2014-15	2015-16	2016-17
Residential	171	225	305	**341**	372
Commercial	112	142	151	**159**	169
Total	283	367	456	**500**	541

4.3. Crucially the OBR predicted that in 2015-16 the residential market would contribute £341mn and the commercial sector £159mn leading to a total of £500mn. The Scottish Government by contrast is suggesting that under LBTT there will be £295mn of revenue from the residential property market compared to the commercial market forecast of £146mn, leading to a total revenue expectation for the first year of £441mn.

4.4. The Scottish Government is therefore being more cautious than the OBR expectations and we would agree that this is wise given the new structure to be introduced and the continued fragility of the property markets. Although the economy is growing much recent activity in the housing market has been supported by government initiatives such as Help to Buy Scotland. Without this support and with the increased regulation over mortgages and finance generally, we question whether the market would have seen the activity that it did during 20013-14 in particular. In fact we believe that the Scottish Government should have been even more cautious albeit with a view that setting lower expectations from revenue (and consequent reduction in the block grant) would have supported the new tax becoming understood and accepted in the market and hopefully returning better than expected transaction figures. In the absence of any apparent Treasury demand on block grant reduction, we do not understand why the Finance Secretary did not opt for this approach.

4.5. The Scottish Fiscal Commission examined the forecasts of the Scottish Government and in the words of the Finance Secretary, the Commission were "able to endorse as reasonable the forecasts made by the Scottish Government" (Official Report, Scottish Parliament 9 October 2014). However, the report noted significant shortfalls in available data, particularly within the non-domestic property arena. Below we provide the relative figures for commercial sales and SDLT yield (estimated lease revenue provided in brackets) together with residential sales and SDLT yields.

Table 2: Residential and Commercial sales value and related SDLT: 2009-14

Figures £mn

Year	Sales	Total Commercial SDLT (est. lease portion)	Res sales	Res SDLT	Total SDLT
2009-10	2300	115 (37)	11200	135	250
2010-11	2300	165 (38)	11300	165	330
2011-12	1800	120 (38)	11000	155	275
2012-13	1600	112 (38)	11300	170	282
2013-14	2600	175 (47)	13800	215	390

Note: The estimate of commercial lease revenue is derived from a proportion of 7.0% of HMRC's reported figures for receipts from new leases granted in these years. This proportion was the level used by the Scottish Government in its 2012 consultation paper on LBTT for non-residential leases. However, this may be an over-estimate to a limited degree because the HMRC data includes revenues from UK residential leases which will not be charged apart from in limited cases under LBTT.

4.6. It is our view that a better and more pragmatic approach for the Scottish Government would have been to base their initial expectations for revenue in 2015-16 upon the average revenue achieved over the past five years including the strong years of 2013-14 (£390mn) and 2010-11 (£330mn). This would have suggested average revenue of **£305mn**.

5. Residential rates

5.1. The residential rates proposed by the Scottish Government are based on an intention to reduce the tax paid for as many house purchasers as possible. This has the effect of shifting the burden onto higher value taxpayers who of course paid more under SDLT anyway. It is also a risk: should transactions in the higher values of £250K to £400k see a marked reduction in activity then this will have significant negative implications for the Finance Secretary's revenue expectations.

5.2. On the highest rate applied (12%), which was a new proposal further to the earlier 2012 consultation, then the issue is really whether this will have a negative impact on a very small number of transactions. In 2013-14 the registers of Scotland reported just 123 such transactions in Scotland. If the LBTT rates had been applicable in 2013-14 this would have netted the Scottish Government just under £14.7mn. This is a significant sum but only represents around 5% of the residential yield and some 3.4% overall. The risk is that the higher rates applicable for this small number of transactions will deter activity. We believe that the 12% rate is too high and that a lower rate of between 8-10% would avoid deterring activity when coupled with the graduated taxation applied to lower rates between £250,000 to £1mn (see paragraph 5.4 below).

5.3. The Scottish Government analysis identifies a 'tipping point' of £325,000 whereupon LBTT starts to attract more taxation than under the former SDLT. With the average Scottish house price below this tipping point in all local authority areas the aim is clearly to avoid tax rises for the vast majority of residential transactions. However there are a number of areas including Aberdeen City, East Lothian, East Renfrewshire and the City of Edinburgh where transactions recorded by the Registers of Scotland are above this tipping point for average detached house prices while East Dunbartonshire has an average at just under £325,000.

5.4. The main concern with the residential rates as set is that for families seeking to move into larger properties they may be deterred by increases in taxation and this may cause a log jam in those who seek to move up the property ladder into larger properties themselves from smaller units. **We believe that the Scottish Government should have set an intermediate rate closer to 5-6% between £250,000 and £1,000,000 rather than applying a major leap to 10% for all consideration above £250,000 (and below £1mn)**.

6. Commercial Property Sales

6.1. For commercial property two chargeable rates have been proposed. No charge on the first £150,000; 3% on consideration between £150,000 and up to and including £350,000; and finally for all consideration above £350,000 a higher rate of 4.5%. This final top rate of LBTT is really the bellwether by which the property investment industry will set its yields for investible property in Scotland or proposed commercial development appraisals. Under SDLT this figure is 4%, albeit applied to the whole of the consideration rather than the graduated progressive approach of Scottish LBTT.

6.2. The issue for commercial property investment is that the vast amount of transactions by value is above the £2mn 'tipping point' whereupon the cost of LBTT surpasses that of SDLT. The reaction of members so far has been that it is unhelpful to be perceived as less competitive than the wider UK on the issue of tax on property transactions. Commercial property investors have arguably more choice than is the case in the residential market and although LBTT will be but one part of a complex decision-making process, we would warn against creating negative and uncompetitive differentials to the wider UK.

6.3. The fact is that values and yields in the commercial sector will have been negatively influenced by the prospect of a 0.5% difference with the rest of the UK. This will not help to attract investment to Scotland where decisions are marginal between Scotland and other parts of the UK. This will partly be based on a straightforward comparison of yields, costs and charges but it will also be partly due to the concern over future potential increases in property taxation which an investor will be concerned about.

6.4. In view of the competitive nature of the commercial property industry we are therefore concerned at the negative impact that a 0.5% increase in the top rate will have on the market. We believe it would be better to have set a 4% top rate initially in order to be perceived to be as competitive as the UK SDLT and to then consider adjustments in the light of market reaction.

7. Commercial Leases

7.1. We are pleased with the decision to retain parity with UK SDLT on this charge. The Non-residential lease change is currently set at 1% for every pound above £150,000 Net Present value of a lease transaction. In other words, it is the one part of SDLT that is determined on a progressive basis. It would have been strange therefore the Scottish Government to have set a higher rate in the context of moving to a progressive tax basis. This is also one of those early up-front charges that businesses face when moving into new premises. Depending on rent and length of tenure, the charge may be significant. For multi-letting retailers or professional services firms with locations across the UK it would have been uncompetitive to have set a higher charge than the prevailing 1% UK rate and therefore we welcome the decision to introduce a comparable rate and threshold.

7.2. The lease charge is one where perhaps a surprising level of revenue might be expected as the economy improves and grows. Unfortunately it is very difficult to establish the exact revenue to be expected under LBTT from this source. In its 2012 consultation paper the Scottish Government estimated that lease duty applicable to Scotland accounted for around 7.2% of the UK total. This would suggest lease duty revenue of around £48mn might have been expected from the 20013-4 returns compiled in late September by HMRC and attributed to non-residential leases (see Table 2 for figures).

8. Key outstanding issues for LBTT

8.1. The introduction and establishment of a complex tax such as LBTT (replacing the equally complicated SDLT) in such a relatively short timescale was always going to be a challenge for the Scottish Government. A number of areas remain outstanding and we identify two key areas of concern to our membership below.

Sales of Multiple Dwellings

8.2. Although much of the Committee's attention will focus on the main headline rates applicable to residential and non-residential LBTT there are other rates where we await a decision by the Scottish Government. One such is the application of minimum proportions of tax to be paid on the sale of multiple dwellings under Multiple Dwellings Relief.

8.3. There are two means of charging sales of multiple dwellings. First, for transactions above 6 or more units s59 of the LBBT Act follows SDLT in allowing such transactions to be treated as if they were non-residential transactions. In other words they are able to be taxed at the 4.5% rate for the total consideration above £350,000.

8.4. Where multiple dwellings relief is applied for by a purchaser then s27 of the LBTT Act 2013 allows this relief subject to the tenets of Schedule 5. The idea is that for multiple purchases of residential dwellings, for example a major investment in a private rented residential portfolio, then this should be taxed at the average individual property price rather than the full consideration of all properties. Confusingly, this charge is applied at the residential rate rather than the non-residential rate as applies under s59. However, if the average property price for the portfolio is actually lower than chargeable band (£135,000 under LBTT) then the government (UK or Scottish) will apply a minimum proportion of tax to be paid on the full consideration. Under SDLT this is set at 1%. Therefore if a portfolio of six properties is sold for a combined consideration of £600,000 then the tax to be apportioned under MDR would be 1% of the nominal tax payable. Thus 4% of £600,000 would be the nominal tax charge under SDLT MDR and this would equate to £24,000 of nominal tax. The minimum proportion would apply and this would be reduced to £2,400.

8.5. Under the proposals of the Scottish Government for a minimum proportion of 40% of the nominal tax payable there would be a huge increase in tax payable for the same portfolio. The nominal tax payable would be equal to £37,300 (£2,300 paid at 2% for consideration below £250,000; £35,000 then paid for the higher 10% rate for the remaining consideration £350,000, making a total nominal payment of £37,300). Applying the Scottish Government's preferred 40% minimum payment of this provides a Scottish MDR figure of £14,920. Clearly this is an enormous increase in liability on a like by like basis compared to the equivalent position under SDLT.

Development transactions and sub sale relief

8.6. The Committee will recall that the Finance Secretary established a working party with a number of stakeholders to examine the issue of a targeted sub sale relief. This working party ended its deliberations in May 2014 and subsequently the Scottish Government produced a consultation paper over the summer proposing a form of targeted sub sale relief that would enable forward funding and other types of genuine commercial activity to be achieved without risking tax avoidance. The criteria was that the transaction must lead to development or redevelopment and that the relief could be applied for at the point of simultaneous sub sale but the tax would be paid and only refunded upon building completion certification at the end of the development process, if achieved within five years.

8.7. The notion of a relief where tax is paid and might only be refunded at a later date subject to many risks and potential delays is not viable. It will be discounted by the industry and will fail to achieve its objective of supporting development and investment across the commercial and residential sector in Scotland. This could therefore have a significant consequence for economic development. The issue is heightened by the application of higher rates of LBTT (4.5%) on commercial land above £350,000 in value because this additional 0.5% will be factored into the development appraisal with values and costs adjusted accordingly.

8.8. We would be pleased to explain our views further at your convenience.

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