

## **Explanatory Memorandum to**

### **The Land Transaction Tax (Specified Amount of Relevant Rent) (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 (Specified Amount of Relevant Rent) (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 these regulations is to specify the amount of relevant rent under paragraph 36(1)(b) of Schedule 6 to the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 (“the LTTA Act”), for the purposes of defining “the specified amount” in paragraphs 34 and 35 of that Schedule.

## 2. Matters of special interest to the Constitutional Affairs Committee

- 2.1 None.

## 3. Legislative background

- 3.1 Schedule 6 to the LTTA Act makes provision about the application of the Act in relation to leases. Part 5 of Schedule 6 makes provision about the amount of tax chargeable on lease transactions. Paragraph 33 of Schedule 6 confirms that tax charged under this Schedule is in addition to the tax calculated under the other provisions; paragraph 34 is an anti-avoidance provision designed to prevent possible manipulation in relation to lease transactions. Paragraph 35 provides for consideration other than rent for a mixed lease. Paragraph 36 provides definitions for “the relevant rent”, “the specified amount” and “annual rent”. In LTT only rent paid for non-residential property is taxed under these rules. Rents paid under residential leases are outside the scope of the tax.
- 3.2 The Welsh Ministers are able to make regulations to specify the amount of relevant rent under paragraph 36(1)(b) of this Schedule. Section 79(2) of the LTTA Act provides that these Regulations will be subject to the affirmative procedure.

## Stamp Duty Land Tax (SDLT) – Finance Act 2016

- 3.3 Prior to the Finance Act 2016, SDLT legislation contained a targeted anti-avoidance rule which prevented taxpayers in leasehold transactions from manipulating the terms of the lease to avoid paying SDLT. The rule prevented the 0 per cent rate of SDLT from applying to any consideration other than rent (for example a premium) where the value of the rent payable under the lease was at least £1,000 per year. In these circumstances, the amount of SDLT charged on any premium up to £150,000 which would otherwise have not been charged to tax was calculated at the next tax rate (1 per cent). The Finance Act 2016 removed the anti-avoidance rule described above.
- 3.4 This change was not reflected in the LTTA Act as it was considered the rule could still have merit as the amount of premium and rents paid for non-residential leases is, typically, lower in Wales, thereby giving a potential greater incentive to attempt to manipulate the tax charge away completely. However, that incentive is tempered by the amount of potential saving that can be made.

## 4. Purpose & intended effect of the legislation

- 4.1 The **purpose** of these Regulations is to set the amount of ‘relevant rent’ that will be used to trigger an anti-avoidance rule in paragraph 34 of Schedule 6. The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) Regulations 2018 sets out that separate tax bands and percentage tax rates apply to chargeable consideration which consists of rent (and therefore which is only relevant in the case of leases). In these cases, tax is to be calculated in accordance with Part 5 of Schedule 6 to the LTTA Act. Table 4 of those regulations set out the rates and bands for chargeable consideration which consists of

rent. Table 3 of those regulations set out the rates and bands in relation to non-residential property for chargeable consideration other than rent.

- 4.2 Consideration has been given to the amount of the “relevant rent” which should be specified in these Regulations. The value needs to strike a balance between ensuring there is an effective anti-avoidance measure in place (to stop taxpayers being able to benefit from two nil rate thresholds of up to £150,000) and ensuring that the rule does not create an unfair tax burden for those who pay only a small amount of annual rent and a premium.
- 4.3 The amount of relevant rent to be specified in the regulation is **£9,000**, which is above the £1,000 SDLT level which was in place up until March 2016. This is an appropriate amount because it is considered not to impose an unfair tax burden for those who pay only a small amount of annual rent together with a premium, but also strikes the right balance in ensuring there is an effective anti-avoidance measure in place (to stop taxpayers being able to benefit from two nil rate thresholds).
- 4.4 Where the relevant rent is the specified amount (£9,000) or greater, the zero rate band for consideration other than rent is dis-applied and that consideration is taxed at the next tax band (1 per cent as set out in Table 3 of The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) Regulations 2018) meaning that the premium does not benefit from a zero rate band. For example, if the buyer pays a premium of £75,000 and is to pay rents with a NPV of £200,000 (and there is an annual rent of £9,000 or greater) there will be a tax liability on the rents of £500 (£200,000 (NPV rents)-£150,000 (nil band for rent element) = £50,000 x 1%). The rules are therefore triggered so that there is no nil rate band for the consideration given other than rent. This results in a further tax liability of £750 (£75,000 x 1%), giving a total tax liability for the transaction of £1,250.
- 4.5 The **intention** of the Regulations is to provide an effective and fair anti-avoidance rule that applies to those who pay significant amounts of rent and consideration other than rent, but not to apply to those who pay only a small amount of rent.

## 5. Consultation

- 5.1 Stakeholders have previously raised concerns that the former SDLT rule was applied too bluntly and applied to transactions where the rent payments are very low. It is considered that by increasing the amount of relevant rent (from £1,000 as previously provided for in the UK up until March 2016 and currently provided in Scotland<sup>1</sup>), will address these concerns.

## 6. Regulatory Impact Assessment

- 6.1 No significant financial effect or impact on the private, voluntary or public sector is anticipated as a consequence of these regulations.
- 6.2 The key potential impact of not making the relevant rent regulation as part of the legislative framework for land transaction tax would be that there would be no effective anti-avoidance measure in place to stop taxpayers being able to benefit from two nil rate thresholds.

### Impact

- 6.3 In the most recent data available, 2015-16, and when the relevant rent rules still applied to SDLT, there were 280 non-residential transactions in Wales that paid a premium and rent

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<sup>1</sup> Paragraph 9 of Schedule 19 to the Land and Buildings Transaction Tax (Scotland) Act 2013

(as measured by reporting a rent net present value ('NPV') figure of more than zero)<sup>2</sup>. Under LTT the rents paid on the grant of a residential lease are not subject to tax. All of these transactions are now potentially liable to pay up to £1,500 (1 per cent of £150,000) more tax compared to SDLT based on the inclusion of a relevant rent rule and the rates and bands set out in The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) Regulations 2018.

- 6.4 If all 280 transactions paid a premium of £150,000 or more and had rent which was of sufficient value for the relevant rent threshold to apply, then this would generate revenue of £0.4m (= 280 x 1% of £150,000). However, it is expected that most premiums will be far lower than £150,000 and relevant rent rules will not apply to all 280 transactions. Half are estimated to be below £30,000, generating a tax liability of below £300, and only in cases where the rent included is high enough for the relevant rent threshold to apply.
- 6.5 Therefore we expect the impact on most of the taxpayers where the relevant rent rules apply to result in a relatively minor increase to their tax liability, with half below £300. As the relevant rent threshold will not apply to transactions with annual rents of less than £9,000), this is likely to impact fewer than the 280 transactions in Wales, perhaps with a revenue impact of less than £0.1m (= £300 x 280).
- 6.6 Overall, it is estimated the rule may increase LTT revenue relative to SDLT by around £0.2m per annum, with a range between £0.1m and £0.4m per annum. This estimate does not include any possible behavioural effects. These are unlikely to be significant given the number of transactions and revenue involved.
- 6.7 The re-introduction of the relevant rent threshold does introduce an additional element to LTT, which has been removed in SDLT. This may be considered to add some complexity to LTT relative to SDLT. However, tax returns relating to leases are generally considered complex and so will nearly always involve a tax professional or conveyancer. These professionals are likely to be familiar with the rule, it having previously operated in SDLT until March 2016. Therefore this change is unlikely to add any significant administrative burden to the tax system. The RIA for the LTTA Act included an estimate for the familiarisation cost incurred by conveyancers and property lawyers.

## Benefit

- 6.8 The key benefit of the relevant rent regulation is to ensure there is an effective anti-avoidance measure in place to stop taxpayers being able to benefit from two nil rate thresholds, but that this is also balanced by ensuring that the rule does not create an unfair tax burden for those who pay only a small amount of annual rent together with a premium. This additional element is therefore considered to add more fairness to the tax system, as it looks to ensure similar value non-residential transactions are treated more equally in terms of the resulting tax liability when taking account both rent and consideration other than rent.

## **7. Post Implementation review**

- 7.1 Transaction data will be closely monitored after LTT goes live to ensure the relevant rent threshold is operating as intended.
- 7.2 Section 77 of the LTTA 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

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<sup>2</sup> Source: Calculations based on HMRC administrative datasets

after the day of the LTTA Act receiving Royal Assent. A review of LTT will encompass all of the subordinate legislation made under the LTTA Act.

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