

Explanatory Memorandum to

The Land Transaction Tax (Transitional Provisions) (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 (Transitional Provisions) (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 These Regulations make transitional provisions in respect of the introduction of land transaction tax (“LTT”) in Wales by the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 (“the LTTA Act”). The provisions ensure that transactions which take place on or after 1 April 2018 receive treatment which is consistent, meaning that transactions are not taxed twice under LTT and Stamp Duty Land Tax (“SDLT”), or not taxed at all. The Regulations also ensure that arrangements commenced prior to 1 April 2018 and for which certain reliefs (which exist in both regimes) were claimed will continue to be relieved under LTT (subject to certain conditions being met). The Regulations will also provide for transitional rules for the purposes of determining whether a transaction completed on or before 26 November 2018 is a higher rates residential property transaction where a person’s main residence is being replaced.

2. Matters of special interest to the Constitutional and Legislative Affairs Committee

- 2.1 Section 78(3) of the LTTA Act provides that the affirmative procedure is prescribed for regulations under section 78(1) where the effect is to impose or increase liability to tax. Given that the effect of certain regulations contained in this instrument is likely to impose tax liabilities, as they will impact on to whom the taxpayer will pay tax and the amount payable to that tax authority, these Regulations are subject to the affirmative procedure.

3. Legislative background

- 3.1 Section 78(1) of the LTTA Act provides for the Welsh Ministers to make such transitional provision as they think appropriate for the purposes of, or in connection with, or giving full effect to any provision under the Act.
- 3.2 Commencement of LTT will take place after SDLT has been dis-applied in Wales, which will be on a date appointed by order of the Treasury under section 16(4) of the Wales Act 2014 (“the Wales Act”).
- 3.3 Section 16(5) of the Wales Act makes provision for SDLT to continue to apply to certain land transactions for which the contract for the transaction was entered into and substantially performed on or before the Royal Assent of the Wales Act on 17 December 2014, or was entered into on or before that date but not excluded by section 16(6) of the Wales Act.
- 3.4 Section 16(6) makes particular provision for certain land transactions to which SDLT will *no longer apply*, for example, where there has been a variation of the contract after 17 December 2014 and to which LTT will then apply.

4. Purpose & intended effect of the legislation

- 4.1 The **purpose** of these Regulations is to set out the treatment of transactions where elements or the events relevant to the transaction occurred before the commencement date for LTT.
- 4.2 The **intention** is to ensure that when SDLT is dis-applied in Wales and LTT is introduced; transactions are not taxed twice (by both SDLT and LTT) but are subject to one of the taxes. Additionally, the Regulations ensure that certain arrangements entered into before 1 April 2018 which are eligible for relief under SDLT and LTT will continue, where appropriate, to be relieved under LTT. Transitional rules for higher rates residential property transactions

provide similar transitional rules to those when the higher rates for additional dwellings rules were introduced to SDLT. The regulations make provision to achieve these purposes for a number of different types of land transactions or arrangements involving land transactions, as follows:

- i) certain contracts for the transfer of land entered into on or before 17 December 2014 with an effective date which is on or after the commencement date and where an intervening event described in section 16(6) of the Wales Act has taken place (regulation 3);
- ii) certain contracts for the transfer of land entered into after 17 December 2014 but before the commencement date, and with an effective date which is on or after the commencement date (regulation 4);
- iii) alternative finance arrangements started under SDLT which will be eligible for relief from LTT, despite the fact that SDLT was payable when the arrangement was entered into (regulation 5);
- iv) alternative finance investment bonds entered into under SDLT which will be eligible for relief from LTT, despite the fact that SDLT was payable when the bond was entered into (regulation 6);
- v) ensuring that LTT is charged in respect of a transfer of an interest in a partnership pursuant to earlier arrangements involving a land transaction, despite the earlier land transaction (which transferred the interest to the partnership) taking place prior to commencement (regulation 7);
- vi) ensuring that LTT is charged in respect of any withdrawal of money etc. from a partnership after the transfer of a chargeable interest under paragraph 19 of Schedule 7 to the LTTA Act, despite the transfer of the chargeable interest to the partnership taking place prior to the commencement date (regulation 8);
- vii) ensuring that the reduction in the amount of tax chargeable for overlapping leases provided by paragraph 7 of Schedule 6 to the LTTA Act is made available despite the fact that the old lease was granted prior to the commencement date (regulation 9);
- viii) ensuring that leases granted prior to the commencement date that were eligible for relief under SDLT relief are, on assignment, will be subject to the LTT rules which treat them as a grant of a lease (regulation 10);
- ix) ensuring that where a lease is granted prior to the commencement date and is subsequently varied to increase the amount of rent payable, it is to be treated as a grant of a new lease and subject to LTT (regulation 11); and
- x) Higher rates residential property transactions – extends the scope of the replacement of main residence exceptions in Schedule 5 to the LTTA Act by providing that a taxpayer who sold their main residence at any point prior to 25 November 2015 and had not replaced it before or after that date will be given until 26 November 2018 to replace that home. This ensures consistency with the SDLT transitional rules provided by section 128(8) and (9) Finance Act 2016.

4.3 Guidance on the application of section 16 of the Wales Act and the other transitional rules will be published jointly with HMRC. A link will be available on the WRA website.

5. Consultation

5.1 Regular engagement with HMRC has ensured a collaborative approach to the development and finalisation of these provisions.

5.2 The Welsh Government has also worked collaboratively with HMRC to develop the guidance.

6. Regulatory Impact Assessment

6.1 A primary aim of the Regulations is to ensure the correct liabilities to tax arise to the correct tax authority and that no taxpayer is unfairly advantaged or disadvantaged by the switch from SDLT to LTT for Welsh land transactions. The key benefit of these Regulations is therefore that they provide taxpayers with certainty, clarity and fairness in the tax liability results arising from their land transactions. There may be a small number of transactions to where the tax liability alters as a result of this change. This will only be to ensure transactions are paying the correct tax, either SDLT or LTT, and if the liability alters between these two taxes, it will be as a result of differences in tax rates. The impact of LTT rates is addressed in a separate impact assessment.

6.2 For the purposes of this assessment, the Regulations have been grouped by tax effect and set out the potential administrative impact of each of the Regulations, as appropriate.

Option 1: Do Nothing

6.3 The key potential impacts of not making these Regulations as part of the legislative framework for LTT would be:

- i) tax revenues incorrectly paid to the WRA or HMRC; taxation of the same transaction under both LTT and SDLT;
- ii) transactions with relevant events falling either side of the commencement date escaping tax, or not being relieve; and
- iii) some taxpayers being liable to the higher rates residential property rules when under SDLT they would not have been liable to the higher rates for additional dwellings rules.

6.4 Thus, these regulations ensure the proper and fair collection of LTT, and SDLT, revenues by the WRA, or HMRC, in Wales where relevant.

Option 2: Provide for the Welsh Ministers to make transitional provision for the purposes of LTT

- **Regulations 3 and 4**

- 6.5 **Description:** **Regulation 3** provides that LTT is charged, except in certain circumstances, where a contract for the transfer of land is entered into on or before Royal Assent of the Wales Act on 17 December 2014 with an effective date on or after the commencement date and an intervening event described in section 16(6) Wales Act takes place. **Regulation 4** provides, except in certain circumstances, that LTT is charged where a contract for the transfer of land is entered into after 17 December 2014 but before the commencement date.
- 6.6 **Impact:** These regulations recognise the impact of the Wales Act 2014. As such the aim of the regulations 3 and 4 is to ensure certainty and clarity of the tax process. Potential administrative impacts may occur as a result of advisers and taxpayers needing to confirm, where they are completing a transaction effected as a result of a contract entered into before the commencement date, whether they are liable to SDLT or LTT. For most cases this should be clear and therefore the cost will be minimal.
- 6.7 **Benefit:** The benefit of these regulations is that they provide certainty of treatment to taxpayers; for example, so that there is clarity as to which revenue authority to file their returns.

- **Regulations 5 and 6**

- 6.8 **Description:** **Regulation 5** makes provision where alternative property finance arrangements are entered into that result in a series of land transactions that would not otherwise arise for an interest bearing mortgage. **Regulation 6** makes provision where alternative finance investment bonds are entered into that result in a series of land transactions that would not otherwise arise for an interest bearing bond issue.
- 6.9 **Impact:** It is estimated that there will be no financial impact as a result of these regulations. They ensure that taxpayers comply with the LTT rules (as with SDLT) and that they send the relevant returns to the Welsh Revenue Authority (WRA), rather than HMRC. The regulations apply consistency in approach in LTT that already applied in SDLT.
- 6.10 **Benefit:** The benefit of these regulations is that they create fairness by ensuring that any alternative finance arrangements that commenced under SDLT will continue to qualify for relief under LTT.

- **Regulations 7 and 8**

- 6.11 **Description:** **Regulation 7** ensures that LTT is charged on a transfer of an interest in a partnership pursuant to earlier arrangements involving a land transaction. **Regulation 8** ensures that LTT is charged on any withdrawal of money etc. from a partnership, after a transfer of a chargeable interest.
- 6.12 **Impact:** It is estimated that there will be no financial impact as a result of these regulations. They ensure that taxpayers comply with the LTT rules (as with SDLT) and that they send the relevant returns to the Welsh Revenue Authority (WRA), rather than HMRC. The regulations apply consistency in approach in LTT that already applied in SDLT.
- 6.13 **Benefit:** The benefit of these regulations is that they ensure that the tax effect is consistent with that of SDLT (if SDLT were to have continued in Wales after 31 March 2018). They

ensure fairness by not allowing taxpayers to gain an advantage from the rules not applying consistently before and after 1 April 2018.

- **Regulations 9, 10 and 11**

6.14 **Description:** **Regulation 9** applies to overlapping leases in cases where a previous lease was entered into prior to the commencement date. It ensures that the amount of taxable rent under the old lease is, for the purposes of LTT, taken into account when determining the tax chargeable. **Regulation 10** ensures in certain cases where a lease was granted before the commencement date, and tax was not payable on the rents due to a claim to a relief that when there is an assignment of a lease after the commencement date, the assignment will be treated as a grant of lease. The rents still payable will therefore be taxable at the point of assignment. **Regulation 11** ensures that in cases where a variation of a lease, granted before the commencement date, to increase the amount of rent takes place (on or after the commencement date), it is treated as grant of a new lease. The rent of the deemed new lease is taken to be the additional rent payable as a result of the variation.

6.15 **Impact:** It is estimated that there will be no financial impact as a result of these regulations. They ensure that taxpayers comply with the LTT rules (as with SDLT) and that they send the relevant returns to the Welsh Revenue Authority (WRA), rather than HMRC. The regulations apply consistency in approach in LTT that already applied in SDLT.

6.16 **Benefit:** The benefit of these regulations is that they ensure that where a tax charge would have arisen under SDLT, the tax charge will now arise under LTT, or, in the case of overlapping leases that where relief would be given for amounts already taxed to SDLT they will not be taxed again to LTT.

- **Regulation 12**

6.17 **Description – Regulation 12** extends the scope of the replacement of main residence exceptions in Schedule 5 to the LTTA Act. It provides that a taxpayer who owns a residential property that is not their main residence, and who had sold their main residence at any point prior to 25 November 2015, and had not replaced it before or after that date will be given until 26 November 2018 in which to replace that home, without incurring the higher rates on that replacement of a main residence.

6.18 **Impact:** It is estimated that there will be no financial impact as a result of these regulations. They apply consistency in approach in LTT that already applied in SDLT.

6.19 **Benefit:** The benefit of these regulations is that they create fairness by ensuring that those who would otherwise have to pay the higher rates on the replacement of a main residence will have the same transitional period to complete that purchase in LTT as is provided in SDLT.

7. Post Implementation review

7.1 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 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.