

Explanatory Memorandum to

The Land Transaction Tax (Specified Amount of Relevant Rent) (Wales) (Amendment) Regulations 2021

This Explanatory Memorandum has been prepared by the Permanent Secretary's Group of the Welsh Government and is laid before Senedd Cymru 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 (Specified Amount of Relevant Rent)(Wales)(Amendment) Regulations 2021. I am satisfied that the benefits justify the likely costs.

Rebecca Evans MS
Minister for Finance and Trefnydd
22 December 2020

1. Description

- 1.1 The purpose of these regulations is to amend the specified 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 Legislation, Justice and Constitution 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 that 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 land transaction tax (“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 Schedule 6. Section 79(2) of the LTTA Act provides that these Regulations will be subject to the draft 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 zero 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 amend the amount of ‘relevant rent’ that will be used to trigger the anti-avoidance rule in paragraph 34 of Schedule 6. The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) Regulations 2018 set out that separate tax bands and percentage tax rates applying 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 specified amount 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 zero rate thresholds) 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 was first specified in the Land Transaction Tax (Specified Amount of Relevant Rent) (Wales) Regulations 2018 at **£9,000**, which is above the £1,000 SDLT level which was in place up until March 2016
- 4.4 The Land Transaction Tax (Tax Bands and Tax Rates)(Wales) (Amendment) Regulations 2020 were made on 21 December 2020 using the made affirmative procedure (section 25(2) LTTA Act) and increased the zero rate tax bands for both consideration which consists of rent in relation to non-residential property and for chargeable consideration other than rent. In both cases the zero rate band was increased from £150,000 to £225,000. The uplift in the zero rate bands necessitates an uplift in the specified amount of relevant rent so as to maintain the same relationship between the size of the zero rate band and the relevant rent amount. These regulations amend the zero rate band to **£13,500, a 50% increase, the same percentage increase made to the zero rate bands.**
- 4.5 Where the relevant rent is the specified amount (£13,500) 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) (Amendment) Regulations 2020) meaning that the premium does not benefit from a zero rate band. For example, if a new lease is granted with a premium of £75,000 and is to pay rents with a NPV of £400,000 (with an annual rent of £13,500 or greater) there will be a tax liability on the rents of £1,750 (= £400,000 - £225,000 = £175,000 x 1%). The rules are therefore triggered so that there is no zero rate band for the consideration given other than rent, which in this example applies to the premium. This results in a further tax liability of £750 (£75,000 x 1%). The total tax liability for the transaction is £2,500.
- 4.6 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 Scotland¹), will address these concerns and maintain the current relationship between the relevant rent figure and the zero rate band.

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

6. Regulatory Impact Assessment

- 6.1 As part of the legislative framework for LTT the Welsh Ministers decided that the LTT regime should have an effective anti-avoidance measure in place to stop taxpayers being able to benefit from two nil rate thresholds.
- 6.2 No significant financial effect or impact on the private, voluntary or public sector is anticipated as a consequence of these regulations. This assessment considers the following two options:
- Option 1 – Do Nothing
 - Option 2 – Increase the specified amount of relevant rent to £13,500
- 6.3 Alternative options, whilst possible, are not appropriate as the Welsh Government wishes the new tax bands and rates to apply in the same manner as under the previous tax bands, and for the anti-avoidance rule to be triggered on a similar basis as when the zero rate tax band was a lower amount.

Option 1 - Do Nothing

- 6.4 The key potential impact of not making these relevant rent regulations as part of the legislative framework for LTT would be that the anti-avoidance measure would still be triggered based on a relevant rent amount calculated by reference to a threshold where tax starts to be paid of £150,000 and not the new threshold of £225,000. That would have the effect, in cases where the anti-avoidance rule was triggered, of not fully providing the benefit of the uplift to the tax bands provided through the Land Transaction Tax (Tax Bands and Tax Rates) (Wales) (Amendment) Regulations 2020.

Option 2 – Increase the specified amount of relevant rent to £13,500

- 6.5 The relevant rent rules and the changes to them mean that no taxpayer will pay more tax than they would have under the previous zero rate bands of £150,000 and the relevant rent amount of £9,000. However, by increasing the relevant rent amount to £13,500 it maintains the same relationship to the new zero rate bands as was established between the previous zero rate bands (£150,000) and the previous relevant rent amount (£9,000). This ensures the benefit of the increase in the zero rate bands benefits all relevant taxpayers.
- 6.6 There is unlikely to be any impact on most LTT non-residential transactions with this change. For the small number of transactions where the change does apply, the effect will be to apply a relatively minor decrease to their tax liability. As the relevant rent threshold will not apply to transactions with annual rents of less than £13,500, this is likely to impact fewer than previously when the relevant rent figure was £9,000. This conforms to the Welsh

Government's intention, by increasing the zero rate bands for non-residential transactions, to reduce the amount of tax payable on non-residential transactions.

- 6.7 Together with the increases in the non-residential zero rate tax bands made through The Land Transaction Tax (Tax Bands and Tax Rates) (Wales) (Amendment) Regulations 2020, it is estimated that LTT non-residential revenue will decrease by £1m.
- 6.8 This change is unlikely to add any significant administrative burden to the tax system.
- 6.9 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.

Benefit

- 6.10 The key benefit of the relevant rent amount is to ensure there is an effective anti-avoidance measure in place to stop taxpayers being able to benefit from two zero 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. It maintains that balance by increasing the relevant rent amount in response to the increases of the zero rate bands for non-residential transactions. It is therefore considered that having provided greater fairness to the LTT tax system through the current relevant rent amount of £9,000, maintaining that fairness as the bands increase is important to taxpayers and the Welsh Government.

7. Post Implementation review

- 7.1 Transaction data will be 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 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.