ICAEW REPRESENTATION
14/16

PROPOSED LBTT SUPPLEMENT ON ADDITIONAL RESIDENTIAL HOMES

ICAEW welcomes the opportunity to provide a submission to the Scottish Parliament's Finance Committee call for written evidence on a proposed LBTT supplement on additional residential homes issued on 7 January 2016 and which is available from this link.

ICAEW Scotland has over 1,500 members who live and work in Scotland. ICAEW Scotland represents the views of ICAEW members who work in Scotland for local, national and international organisations across the private and public sectors.

We would be happy to discuss any aspect of our comments and to participate in further consultations on this topic.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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RESPONSES TO SPECIFIC QUESTIONS

Q1 The Scottish Government's overall policy objectives in introducing the supplement

1. We are disappointed that the Scottish Government has chosen to substantially replicate the proposal from the UK Government to introduce broadly the same measure in relation to Stamp Duty Land Tax ('SDLT').

2. The proposal to replicate the UK SDLT charge highlights the serious policy conflict posed by devolved taxes, namely the conflict between following a policy that may be coherent and consistent at the UK level but which may not be the best solution when considered from a devolved tax perspective. If the Scottish Government simply adopts broadly the same proposals as the UK Government this brings into question the justification for devolved taxes and he benefit of introducing a separate Scottish revenue authority with all the consequent costs which are being borne by the Scottish taxpayer.

3. We believe that the UK Government's proposals for a 3% SDLT charge, as set out in a consultation document published on 28 December 2015, are fundamentally flawed, run counter to the policy and will result in considerable extra complexity and burdens. In ICAEW's draft response to that consultation we have said that given the policy aim is to provide affordable homes to first time buyers, it is wrong that first time buyers will be subject to the higher rate if:

   - their parents need to take a share in the property in order to secure a mortgage;
   - they are buying jointly with somebody else who owns another property (possibly otherwise unconnected);
   - they have a small share in a multiple ownership family property passed down through a couple of generations that they could not occupy as their main home;
   - they are a partner in a partnership (eg, a farming partnership or a veterinary practice) that provides accommodation for its employees
   - there has been a forced inheritance of a property abroad due to the forced heirship laws of that country.

4. Further, we consider that the UK Government's SDLT proposals are unfair to smaller scale investors as it is proposed to provide an exemption from the higher rates for bulk purchases of 15 or more properties: we believe this is wrong in principle.

5. Given the above concerns with the UK's Government's proposals, we believe that substantially copying the UK's proposals represents a missed opportunity for the Scottish Government to consider critically whether these proposals are justified in policy terms and that this is an opportunity to distinguish Scotland as an attractive location to live, work and do business by not introducing what we believe is a fundamentally flawed proposal.

6. We also question the overall justification for promoting home ownership at the expense of other methods for the provision of residential accommodation. What evidence exists to support the supposition that home ownership is preferable, especially when it is inherently unsuitable for a great many people, including students and migrant workers?

7. In 'Scotland's Spending Plans and Draft Budget 2016-17', the Scottish Government clearly recognises the importance of all forms of tenure in the provision of residential accommodation: "we will also take forward further plans with our partners to help address the development, financing, infrastructure and collaboration issues constraining increased housing supply across all tenures".

8. With appropriate regulation, a thriving private rented sector offers an alternative approach to the provision of safe, high quality, living accommodation than many will find more attractive option than home ownership.

9. The Scottish economy would benefit from a thriving private rented sector since landlords who are subject to appropriate regulations to safeguard standards and quality of accommodation will need to spend money on maintenance as well as investing in property improvements, something which may private home owners may not do.

10. The Scottish government will also benefit from a healthy private rented sector through the tax revenue which it generates. It should be borne in mind that individual investors based in Scotland will pay the Scottish rate of income tax from April 2016 onwards whereas corporate investors will not be paying any tax to the Scottish government on their profits. Any measure which encourages corporate investment at the expense of individual investors will therefore reduce the Scottish government's revenue receipts.

11. According to a recent YouGov survey commissioned by the Council of Mortgage Lenders (CML), 15% of buy-to-let landlords plan to stop or reduce their investment in the private rented sector as a result of recent tax proposals. A further 13% plan to sell off some or all of their portfolio and 6% will review the mix of properties that they own.

12. These results are based on changes proposed for the UK as a whole, including:

    i) The restriction of tax relief for interest and finance costs borne by individual landlords to basic rate only
    ii) The abolition of the wear and tear allowance for furnished lettings
    iii) The proposed higher rates of SDLT on purchases of additional residential properties in England, Wales or Northern Ireland.

13. Points (i) and (ii) apply equally in Scotland and are already placing a considerable strain on the private rented sector. Introducing an LBTT supplement would broadly replicate point (iii) and hence can be expected to lead to a similar effect in Scotland to the results indicated by the CML survey.

14. The survey suggests that a total of 34% (over a third) of landlords will reduce their investment in the private rented sector as a consequence of proposed tax changes. This does not take account of a further 11% who are currently undecided on their future plans, so the final total could be as high as 45%.

15. Reductions in investment at this sort of level could have a severe impact on the availability of affordable residential accommodation, a policy outcome which is the opposite of what is needed. The CML's view is that the overall impact of the proposed UK tax changes 'will be to lift rents higher and to narrow the availability of homes in the private rented sector'. Replicating broadly the same tax changes is likely to have the same effect in Scotland.

16. The private rented sector is an essential element in the provision of residential accommodation to students, migrant workers and many other individuals with little or no interest in purchasing property. The availability of affordable, high quality, rented accommodation is essential to make Scotland an attractive place to come to live and work. Measures which significantly reduce the availability of such accommodation therefore run the risk of damaging the Scottish economy.

17. There is an opportunity here to differentiate Scotland from the rest of the UK. By refraining from introducing any LBTT supplement, the Scottish Government could distinguish Scotland as a more beneficial environment for property investment, thus encouraging the growth of high quality, affordable, rented accommodation in Scotland with consequent benefits to the Scottish economy, workforce, student population and overall quality of life.

Whether it is likely to complement the Government's commitment to supporting home ownership in a balanced and sustainable way

18. We do not agree that the measure would complement the Government's commitment to supporting home ownership in a balanced and sustainable way.

19. Home owners on low incomes are far less likely to invest in their properties to improve safety standards or energy efficiency than are landlords within a well-managed and appropriately regulated private rented sector such as already exists in Scotland. We consider that the measure is more likely to lead to the long-term deterioration in the quality of housing stock at the lower end of the market.

Whether it helps to ensure that the tax charge is proportionate to the taxpayer's ability to pay

20. Any form of transaction-based tax levied on the capital value of property carries inherent difficulties regarding the taxpayer's ability to pay.

21. This becomes most relevant to the current proposals when we begin to look at some of the areas covered below, such as individuals who face a delay in selling their current home and migrant workers.

22. For example, a worker relocating to Scotland with a large family will necessarily need to purchase a reasonably large property. It does not follow that this implies an ability to bear an increased tax charge.

Q2 The proposed 3% rate for the supplement and the £40,000 purchase price at which it is proposed to take effect

23. We are disappointed to note that the current proposals include a partial return to the previous 'slab' system applying to Stamp Duty Land Tax on residential property prior to December 2014: with a rate of 3% applying to the entire purchase price on property with total consideration in excess of £40,000.

24. This creates a 'cliff edge' with an immediate charge of £1,200 applying as soon as the purchase price of a property exceeds £40,000.

25. 'Cliff edges' of this type create artificial distortions in the property market. We welcome the general approach to LBTT which precludes such 'cliff edges' but are concerned by this partial return to a 'slab system' under the current proposals.

26. We believe the current proposals are therefore not in line with the Scottish Government's stated commitment to a progressive tax system. ("The Scottish Government is committed to a progressive taxation system and has applied this to decisions on existing tax powers" – 'Scotland's Spending Plans and Draft Budget 2016-17').

27. The proposed 3% rate of supplement leads to prohibitive rates of LBTT at the higher end of the market, with overall rates of 13% on property worth in excess of £325,000 and 15% on property worth in excess of £750,000.

28. Such high rates may deter senior executives and entrepreneurs considering potential relocation to Scotland (see paragraphs 57-60 for further comments regarding individuals potentially relocating to Scotland). This is contrary to the Scottish Government's stated desire to 'ensure that Scotland remains a competitive and attractive location for business' ('Scotland's Spending Plans and Draft Budget 2016-17').

29. We also consider that applying the proposed 3% supplement to purchase consideration in excess of £250,000 is unnecessary within the context of the stated policy intention of 'supporting home ownership in a balanced and sustainable way'. We cannot see how applying a supplement on consideration in excess of this level will assist first-time buyers or the vast majority of other home owners in Scotland.

30. Limiting the supplement to the first £250,000 of purchase consideration would ensure that it "targets the lower end of the market, where demand for properties for investment purposes or second homes could make it difficult for new entrants to the market to purchase a main residence" as stated in 'Scotland's Spending Plans and Draft Budget 2016-17'.

Q3 The Scottish Government's estimate that the measure will raise between £17 million and £29 million in 2016-17

31. We cannot comment on the validity of this estimate without sight of the evidence on which it is based.

32. We are concerned, however, that this estimate does not take account of behavioural changes arising as a result of the supplement, for example:

- A reduction in the level of investment within the private rented sector
- Decisions made to purchase property elsewhere (including overseas) as a consequence of the supplement
- Decisions made to purchase cheaper property, or to refrain from making any purchase at all, as a consequence of the supplement
- Forestalling (see paragraphs 68-69 for further comments).

33. The first three examples above will also have the added result of reducing the level of receipts from LBTT at the existing 'normal' rates.

34. The first example above will additionally lead to a reduction in receipts arising from the Scottish rate of income tax. The UK government would also see a reduction in receipts from other taxes, including capital gains tax, inheritance tax and, depending on which reliefs are introduced, corporation tax.

Q4 Any reliefs or exemptions that we consider should form part of the legislation

35. We consider that the following exemptions and reliefs, considered further below, should form part of the legislation:

- Main residence relief
- Rollover relief
- Transfers with no change in the ultimate beneficial ownership of the property
- Transfers with no consideration other than the assumption of debt
- Exemption for accredited landlords
- Furnished holiday lettings
- Relocation for work or business purposes

36. It would also be appropriate to extend all existing LBTT reliefs to ensure that the supplement is covered by the relief, including:

- Multiple dwellings relief
- Alternative property finance relief
- Crofting community right to buy relief
- Group relief
- Reconstruction relief
- Acquisition relief
- Relief for incorporation of limited liability partnership
- Charities relief

Main Residence Relief

37. The HM Treasury consultation on 'Higher rates of SDLT on purchases of additional properties' suggests that purchases of a replacement main residence should be exempt from the higher rates. This is achieved by:

    a) Exempting any purchase of a main residence which replaces another property used as a main residence at any time within the previous 18 months where that other property has been disposed of at the time of the new property's purchase
    b) Providing a refund mechanism where the new property is purchased as a main residence and the former main residence is then disposed of within 18 months

38. We consider that the refund mechanism under (b) is inappropriate for the LBTT supplement as it will place an undue burden on those unable to sell their former main residence before (or at the same time as) purchasing their new main residence. It will be extremely difficult in many cases for such purchasers to fund an additional 3% of the new property's purchase price under these circumstances and this would prevent many such transactions from proceeding.

39. Such an approach is also particularly inappropriate in Scotland where missives are typically concluded some time before the date of entry, creating a legal obligation on the purchaser to proceed with the transaction. A purchaser who is then unable to fund an additional 3% cost on the purchase will be faced with penalties arising under the purchase contract. Such an outcome must be regarded as extremely unfair.

40. We therefore consider that all purchases of property should be provisionally exempt from the LBTT supplement where the purchaser:

    (i) Intends to occupy the new property as their main residence, and
    (ii) Has disposed of, or intends to dispose of, their current or former main residence

41. Full exemption should then apply when the conditions at (i) and (ii) have been satisfied.

42. If the conditions at (i) and (ii) are not satisfied within a specified period then the LBTT supplement would become chargeable at that point (subject to any other exemptions or reliefs which apply).

43. We also consider that main residence relief should extend to exempt the acquisition of an additional interest in an individual's current main residence.

Rollover Relief

44. It is iniquitous that an individual who buys a small property (for any purpose) and then subsequently purchases a larger property (but without selling their first property) should suffer a higher tax charge than an individual who buys a larger property first and then subsequently buys a small property.

45. There are also many cases where individuals may have a minor interest in a property which it is not practical for them to sell. This often happens in the case of inherited property owned jointly by several siblings or cousins; or in the case of minor legal or equitable interests in property overseas.

46. We would therefore suggest that any individual who already holds an interest in another residential property should have the option to claim partial relief from the supplement. This relief would enable them to pay a reduced supplement based on the value of their existing property interest.

47. Where an individual already holds interests in two or more residential properties, the relief should be based on the most valuable of those property interests.

Transfers with no change in ultimate beneficial ownership

48. At present, a transfer to a company under the control of the transferor or their associates may attract an LBTT charge. We consider that such transfers should be fully exempt from LBTT, including the proposed supplement, as there is no change in the ultimate beneficial ownership of the property.

49. Such a relief would need to be subject to appropriate anti-avoidance measures (considered further in paragraphs 62-63).

Transfers with no consideration other than the assumption of debt

50. Applying LBTT to gifts of property is unnecessary within the context of the stated policy intention of "supporting home ownership" since there is no possibility of potential first-time buyers or other home owners being in competition for the purchase of such properties. We also consider that it is unfair to impose any tax charge on a gift of property.

51. Gifts of property should therefore be fully exempt from LBTT, including the proposed supplement. This should include cases where the transferee assumes responsibility for a mortgage or other charge over a property (currently treated as deemed consideration).

52. Such a relief would need to be subject to appropriate anti-avoidance measures (considered further in paragraphs 64-65).

Accredited Landlords

53. In order to maintain the quality of Scottish housing stock and to meet the ever-increasing demand for housing, we consider that it would be appropriate to provide an exemption from the supplement for accredited landlords. Existing accreditation schemes could be developed incorporating appropriate criteria.

54. We consider this approach to be more appropriate than the suggested approach for the higher rates of SDLT set out in HM Treasury's consultation on 'Higher rates of SDLT on purchases of additional properties' as it allows for a qualitative approach to the benefits of individuals, companies or other entities investing in Scottish housing rather than an approach based purely on quantity or legal structure. We do not see how a purely quantitative approach will guarantee the quality of Scottish housing stock and nor do we see the relevance of legal structure.

55. Furthermore, for the reasons explained in paragraph 10, any measure which encourages corporate investment at the expense of individual investors would have the effect of reducing the Scottish government's revenue receipts.

Furnished Holiday Lettings

56. Tourism represents a significant and important part of the Scottish economy. The industry relies on the availability of high quality holiday accommodation for tourists and other visitors. Property purchased for the purposes of furnished holiday letting should therefore be exempt from the supplement.

Relocation Relief

57. Individuals who relocate for work or business purposes and purchase a property in their destination location may not wish to sell their existing home, especially if the relocation is intended to be temporary or if the individual is uncertain about their long-term intentions. Individuals may also need to retain their existing home for family reasons.

58. Imposing the supplement under these circumstances will act as a deterrent to potential migrants from overseas or elsewhere in the UK and will be detrimental to the Scottish economy as it will inhibit Scottish businesses attempting to recruit the most talented individuals to join the Scottish workforce.

59. It is also unfair that a worker intending to relocate to Scotland who must retain a property elsewhere (e.g. as a family home) should be placed at a disadvantage compared with another migrant worker without such a property.

60. For these reasons, we consider that it is appropriate to include an exemption for individuals relocating for work or business purposes.

Q5 The potential for tax avoidance under the supplement and how this should be addressed

61. Some of the reliefs outlined above and the approaches outlined in paragraphs 71-83 would require anti-avoidance legislation to prevent them from being abused.

Transfers with no change in ultimate beneficial ownership

62. We would suggest that the relief should be withdrawn if the transferee company is sold on to an unconnected party within a specified period (e.g. within twelve months).

63. A sale of some of the shares in the company to an unconnected party within this period should lead to a partial withdrawal proportionate to the number of shares sold (as a proportion of total shares issued).

Transfers with no consideration other than the assumption of debt

64. This relief should be subject to restrictions in order to prevent abuse. We would suggest that the relief is not available where:

    i) The debt has been in existence for less than twelve months, and
    ii) The debt was taken on in order to secure a tax advantage

65. An alternative might be to restrict this relief to gifts to a defined class of relatives or into a settlement for the benefit of a defined class of relatives.

Joint Owners

66. Under our suggested approach to joint owners outlined in paragraphs 74-75, we would suggest that any subsequent lifetime transfer of an interest from a joint owner who was not subject to the supplement to a joint owner who was subject to the supplement should lead to an LBTT charge on the transferred interest. This charge should be equal to the supplement which would have been charged on the transferred interest at the time of the original purchase.

67. Where there is any consideration for the transfer of a joint interest, double tax relief should be available to prevent a double charge.

Q6 The likely impact of forestalling

68. Some degree of forestalling is likely to occur. This will lead to a temporary increase in the level of property transactions taking place in the period immediately preceding the introduction of the supplement; followed by a period of reduced activity thereafter.

69. The recent transition from SDLT to LBTT for Scottish property purchases taking place on or after 1st April 2015 appears to have led to a significant reduction in the level of Scottish property transactions for several months after the change. We would suggest that the available

data relating to this transition should be reviewed in order to provide the best indication of the probable level of forestalling arising as a consequence of the introduction of an LBTT supplement.

Q 7 Other comments

70. The legislation will need to address a number of other key issues, as outlined below:

Additional Property

71. It is important to define when an individual will be considered to be acquiring an additional property. We would suggest that the initial 'default' test should be that an individual will be deemed to have acquired an additional property where:

    i) They either:
       a. already had an interest in another residential property prior to the purchase of the new property, or
       b. they acquire two or more residential properties simultaneously, and
    ii) They have an interest in two or more residential properties on the due date for submission of the LBTT return

72. In a case falling within (i)(b) but not (i)(a), one of the newly acquired properties should not be treated as an additional property. The purchaser should be able to nominate which property is not an additional property.

73. In the interests of fairness, it is important that any interest in another residential property anywhere in the world should be taken into account. This should, however, be subject to the rollover relief described in paragraphs 44-47 - which is important to prevent individuals from being disadvantaged by minor property interests overseas.

Joint Owners

74. Two or more individuals may purchase property jointly for a variety of reasons. In some cases, it will be driven by necessity, such as in order to satisfy a lender's requirements. In such cases, it would be unfair to impose the supplement on a joint purchaser who has no interest in any other residential property.

75. We consider that the fairest approach is to treat each joint owner on an individual basis. Hence, for example, where two individuals acquire a property jointly (on an equal basis) and only one of them has a pre-existing interest in another residential property, then the supplement should only apply to half of the purchase consideration.

Married Persons and Civil Partners

76. We cannot see any logic for treating married persons and civil partners differently to other individuals.

77. We would suggest that the simplest and fairest approach is to treat each person on an individual basis.

Trusts

78. Provision will need to be made for purchases made by trusts. In this specific regard, we consider the approach outlined in the HM Treasury consultation on 'Higher rates of SDLT on purchases of additional properties' to be appropriate for the LBTT supplement also.

Companies and other Corporate Entities

79. The legislation will need to make provision for the treatment of companies and other corporate entities.

80. Subject to the reliefs outlined in paragraphs 35-36, we would suggest that all purchases of residential property by companies and other corporate entities should be subject to the supplement.

Partnerships

79. The legislation will also need to make provision for the treatment of partnerships.

80. We would suggest that, for property purchases made by a partnership, individual partners are treated in the same way as we have suggested for joint owners, as described above.

81. For subsequent transfers of interests in partnership property, the existing rules should be extended to cover the proposed supplement.

82 This is subject to the proposed rollover relief described in paragraphs 44-47 being available in respect of any interest in partnership property.

83. In the interests of fairness, the legislation should be framed in such a way that it applies equally to partnerships constituted under Scottish Law or English Law or to any arrangements under the laws of any other territory which are similar to a Scottish or English partnership.