Land transaction tax

What is 'land transaction tax'?

1.1 Land transaction tax (LTT) replaced stamp duty land tax (SDLT) in Wales from April 2018.[1] It is an ad-valorem transaction tax levied on the transfer of a property. It is paid by the purchaser, but its incidence is on the house price so the burden actually falls on the seller.[2]

1.2 LTT retained many of the same features as SDLT including different treatment for residential and commercial properties, a tax-free threshold as well as a 3 per cent surcharge on additional property purchases. But there are also some notable differences. For example, LTT has different rates and thresholds; it does not include a relief for first-time buyers; and it is collected by the Welsh Revenue Authority (WRA) rather than by HMRC.

Forecast methodology

1.3 This section describes the three stages of our methodology for generating LTT forecasts:

- first, we produce an **in-year estimate** using information from the WRA and other property market sources as it becomes available over the course of the year;
- next, we produce our **pre-measures forecast**, drawing on several models to project the property market over a five-year horizon and then calculate the expected revenue; and
- finally, we add estimates of the effects of any **new policy measures** to produce our post-measures forecasts.

In-year estimate

1.4 Our forecasts are invariably produced part-way through a fiscal year. We therefore have some monthly outturn data on LTT receipts for the year in progress, as well as some information about the performance of the property market and the economy in general.

1.5 A key judgement is whether to place more weight on recent LTT receipts or on leading property market indicators. We typically place more weight on grossing up year-to-date receipts, though we might take a different approach if we believed receipts early in the year

[1] Both taxes are broadly based on the historical tax 'stamp duty', one of the oldest forms of taxation having been originally introduced on a range of products in 1694. The original duty required legal documents associated with a transaction to be authenticated by means of a physical 'stamp'. Stamp duty was replaced with SDLT in December 2003. SDLT in Scotland has also been devolved to the Scottish Government and was replaced with land and buildings transaction tax (LBTT) in April 2015.
[2] Best, M. and Kleven, H., *Housing market responses to transaction taxes: Evidence from notches and stimulus in the U.K.*, June 2017.

were not representative of full-year activity, or if we had less receipts data than usual because of the timing of a forecast.

1.6 We normally produce a first monthly profile of LTT receipts using our previous forecast. We assume that current year receipts will follow a similar monthly pattern to previous years, adjusted where necessary for things that can be anticipated. The property market typically exhibits a degree of seasonality, with more sales taking place in the summer. Additionally, more transactions tend to complete on a Friday and before public holidays such as Easter. Changes in the number of Fridays per month and the timing of Easter are known in advance. Policy changes announced or implemented mid-way through a year can also affect the profile of receipts. As LTT is a relatively new tax, we also draw on the historical monthly patterns of SDLT in Wales when producing in-year estimates.

1.7 The in-year estimate is a critical element of our medium-term forecast as any errors in the starting point it provides will compound across the rest of the forecast. For example, in our first LTT forecast in November 2017 we generated a 2017-18 in-year estimate of £80 million for commercial SDLT in Wales based on the historical monthly profile and receipts outturns for April to September of that year. Given our forecast for growth in the commercial property market, this led us to forecast £86 million of receipts in 2018-19. In the event, the monthly pattern of receipts in 2017-18 proved very different, with much stronger receipts at the end of the year. The final outturn was £20 million (25 per cent) higher than expected.

Pre-measures forecast

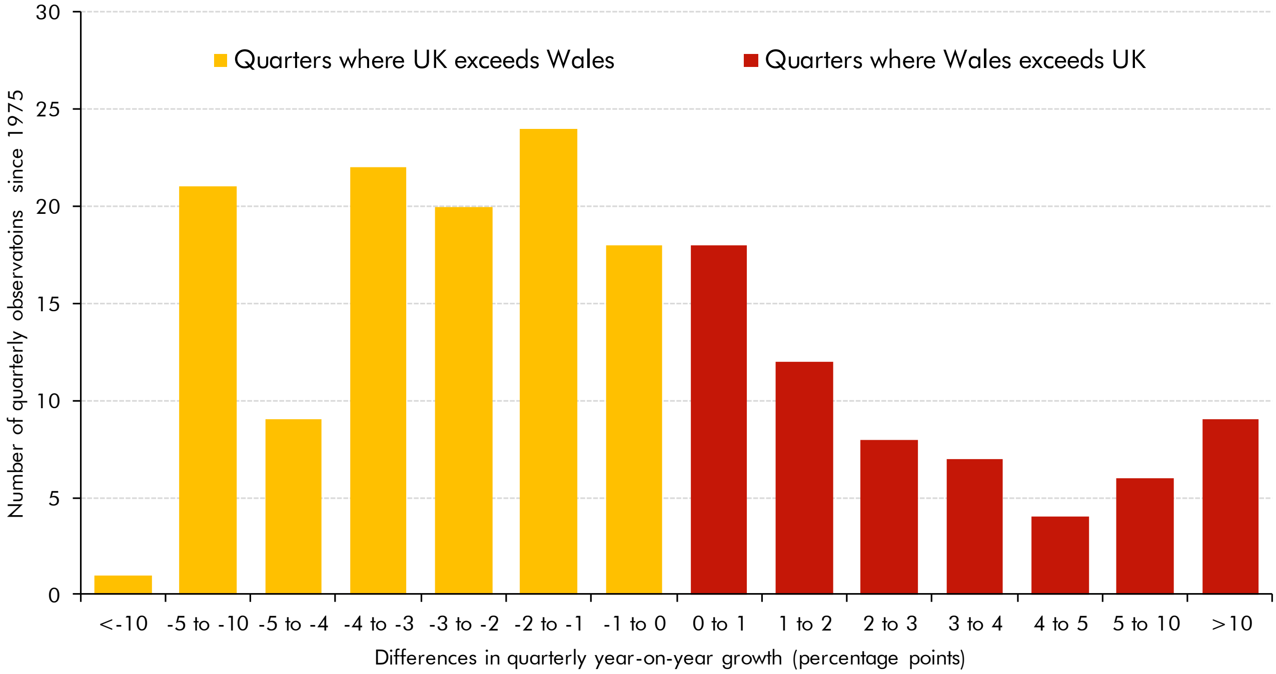
1.8 We produce our forecast using four separate 'price bins' models – one each for residential main rates, the additional properties surcharge, commercial sales and commercial leases. These are operated on our behalf by analysts in the Welsh Government based on our forecast assumptions and judgements.

1.9 To produce the pre-measures forecast we start with a representative base year of transactions. Given the succession of policy changes in recent years, finding a base year that is not somehow distorted by those changes has been a continuing challenge. We do not have access to individual taxpayer records held by the WRA. Instead, analysts in the WRA provide transactions data aggregated into relatively small 'price bins' that are representative of the true price distribution. The model then calculates the tax due on the average price of transactions within each bin. This is projected forward in line with our forecasts for property prices and transactions, with the tax then recalculated and aggregated for each future year. We use a similar modelling approach to produce our SDLT forecasts.

1.10 A key judgement is whether Welsh property prices and transactions should be assumed to move in line with those for the UK as a whole. We generally assume that they will move together, so that while house prices start at different levels, prices neither converge nor diverge any further. That said, short-term differences in property market performance will have implicitly been captured via the in-year estimate process. In our 2019 WTO we reflected the stronger momentum in Welsh house price inflation compared to the UK as a whole in our near-term house price assumptions.

1.11 Although we have made short term adjustments to house prices, we maintain our assumption that determinants rise in line with those for the UK over a longer horizon, in the absence of data to the contrary. This is informed by analysis of property market determinants over longer periods of time, drawing on sources such as Nationwide's house price index, as shown in the chart. This plots the distribution since 1974 of percentage point differences in annual house price inflation between Wales and the UK as a whole.[3]

Chart 1.1: Distribution of relative house price inflation in Wales and the UK



1.12 We also consider different trends in the composition of transactions within each property market. For example, the top-end of the price distribution and buy-to-let purchases, which are much more heavily taxed than most owner-occupier transactions.[4] We examine how trends in these fiscally important subsets of the market might differ from the average captured in our economic forecasts, and adjust our receipts forecast as appropriate.

1.13 The thresholds for LTT are fixed in cash terms, so house price inflation increases the share of transactions taxed at the higher rates, increasing the average effective tax rate. This is known as 'fiscal drag', which results in receipts rising faster than the overall value of transactions over time. When compared to SDLT, the more progressive nature of LTT should lead to greater fiscal drag as higher marginal rates apply at lower prices. We assume that the effect of fiscal drag on receipts is slightly tempered because the higher tax rates would themselves deter some transactions from taking place.

[3] The distribution displayed in the chart is also consistent with the findings of Geoff Meen's 1999 paper, Regional house prices and the ripple effect: a new interpretation. This describes the spatial dynamics of house prices in different regions of the UK over time, suggesting that periods in which some regions experience faster house price inflation than others will tend to be transitory and lower inflation regions will tend to catch up over time. In the long-term this limits divergence between regions.
[4] See Chapter 4 of our July 2019 *Fiscal risks report* and Chapter 5 of our July 2017 *Fiscal risks report* for further discussion.

1.14 We also make a judgement about the profile of refunds associated with the additional properties surcharge. As the time period within which refunds can be claimed is longer than the LTT system has been in operation, this is informed by experience with SDLT refunds.

Post-measures forecast

1.15 To produce our post-measures forecast we then add on the effects of any policy changes announced since our most recent forecast was published. The approach taken to estimating the cost or yield of a new policy depends on the nature of the change.

1.16 Changes to tax rates and thresholds can typically be estimated using our existing forecast models. Here, we would first generate a static costing by applying the new tax parameters to the pre-measures forecast for the tax base (i.e. the number of transactions in each 'price bin' over the forecast period). We would then incorporate any behavioural effects that are likely to result from the policy change. One way that we model such responses is by using price and transaction elasticities that have been built into the models.[5] We also account for the possibility of the timing of transactions being altered in response to policy changes – either being brought forward (forestalling)[6] or delayed (stalling). Further discussion of forestalling can be found in the key uncertainties section of this chapter.

1.17 Other changes, such as introducing a new relief or surcharge to a subset of taxpayers, would normally require a bespoke costing model as the particular group of buyers or types of property affected would not usually be treated separately in the forecast model.

[5] For more detail see Chapter 4 of our 2017 *Forecast evaluation report*. Also, see OBR supplementary release 22 January 2015, *Stamp duty land tax policy costing elasticities – December 2014* and OBR supplementary release 10 October 2017, *Residential SDLT elasticities*. These elasticities no longer cover the full range of behaviours that we need to consider. Devolution means we need to consider cross-border effects where tax regimes differ. And we also consider cross-market effects whereby a policy changes the composition of owner-occupiers, buy-to-let investors, and (more importantly outside Wales) first-time buyers. We discussed this in our March 2019 *Devolved taxes and spending forecast* publication when costing the Scottish Government's increase in the additional dwellings supplement for LBTT.
[6] See Mathews P., *OBR Working paper No. 10: Forestalling ahead of property tax changes*, October 2016.