

NUGGETS – LBTT AT 4, STILL COINING IT IN?

BY DR JOHN BOYLE

When we [first wrote in detail about the 2-year-old LBTT](#) (or Land & Buildings Transaction Tax to give its full name), it had emerged as the Scottish Government's problem child, leaking away revenues and causing seizures in the middle to upper ends of the housing market.

However, over its third year, something unexpected happened – LBTT started behaving and changed from tantrum provoking toddler to a beloved tiny superhero to its Scottish Government parents, working hand-in-hand with its little brother ADS (or Additional Dwelling Supplement) to fill its parents' coffers. We [wrote about this surprising development last year](#).

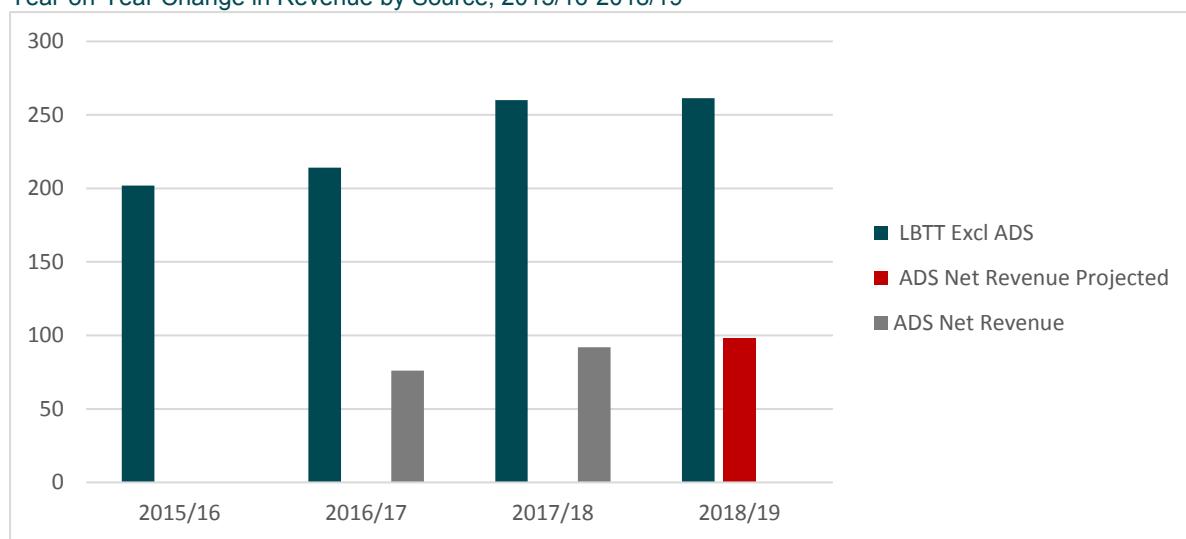
So significant was this progress that there were great hopes for LBTT over its fourth year, with another growth spurt anticipated. So with the end of the 2018/19 financial year, how has it fared?



LBTT HAS STOPPED GROWING

Perhaps disappointingly for the Scottish Government, LBTT stopped growing in its fourth year. After a fairly torrid first two years (when revenues significantly undershot forecasts), LBTT eventually found its feet in its third year, raising revenues by nearly a quarter on the year before. However, it has barely grown at all in Year 4. Little brother ADS (a year younger than LBTT) has continued to grow, but also at a much reduced rate. It was helped by a raising of its allowance from 3% to 4% in January this year. The projected revenue from both taxes in 2018/19 now looks likely to be just 2% higher than 2017/18.

Figure 1 Projected residential LBTT and ADS revenues are set to be c.2% higher than 2017/18
Year-on-Year Change in Revenue by Source, 2015/16-2018/19



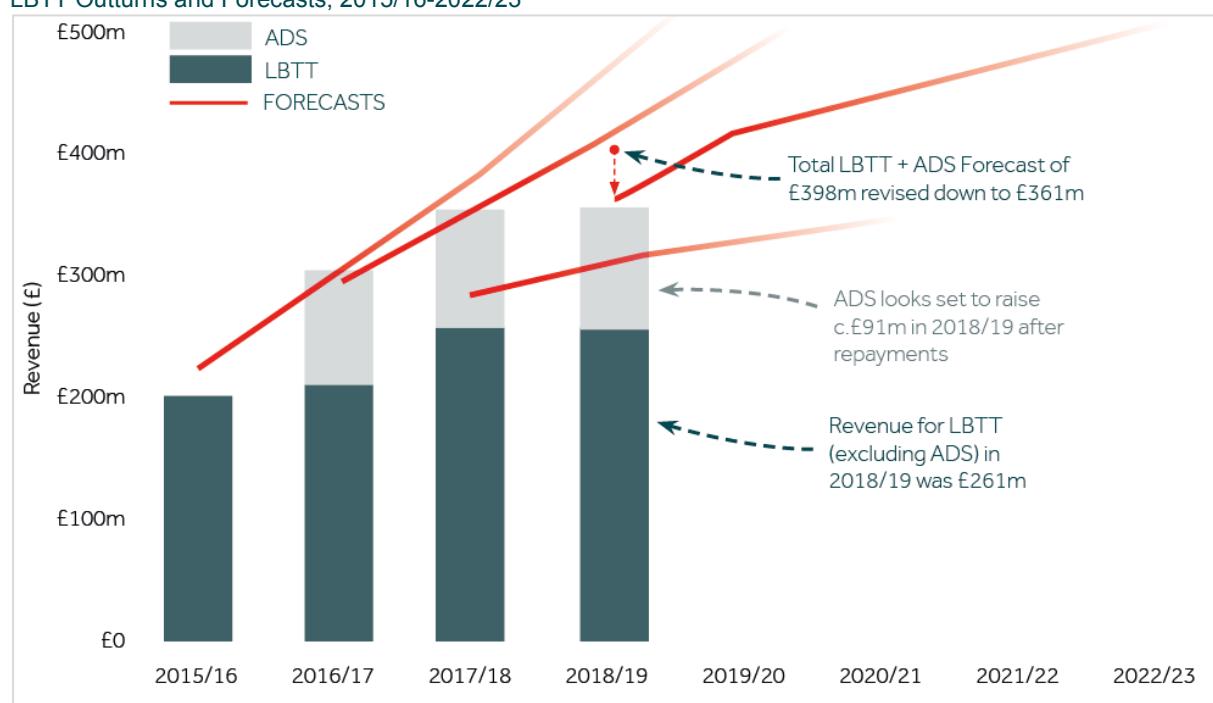
Source: Revenue Scotland

So disruptive was LBTT in its first year, that the Scottish Government brought in the Scottish Fiscal Commission (SFC) as its child monitor. Under the watchful eye of the SFC, LBTT's behaviour began to become much more predictable. The SFC was confident after the strong showing in its third year report card that it forecast that LBTT would grow stronger and more assured in its fourth year. However, this has not happened. After surging to £260m in Year 3, the SFC forecast residential LBTT to reach £305m in Year 4. However, poorer than expected performance after the start of the year meant this was revised down to £267m part-way through the year, but LBTT also failed to meet this much reduced target, hitting just over £261m by financial year end, a rise of less than 1% on the previous year.

ADS generated a gross revenue of £121.5m in 2018/19. However, part of this [may need to be repaid to house purchasers if they have sold their main residence in an 18-month period](#). Accounting for a 25% repayment rate would contribute a net £91m; this would take the total LBTT/ADS tax take to £352m in 2018/19.

Figure 2 LBTT levels have failed to meet forecasts

LBTT Outturns and Forecasts, 2015/16-2022/23



Source: Scottish Government

So, why the poorer than expected performance?

LBTT'S FORTUNES ARE TIED UP WITH THE OVERALL HOUSING MARKET

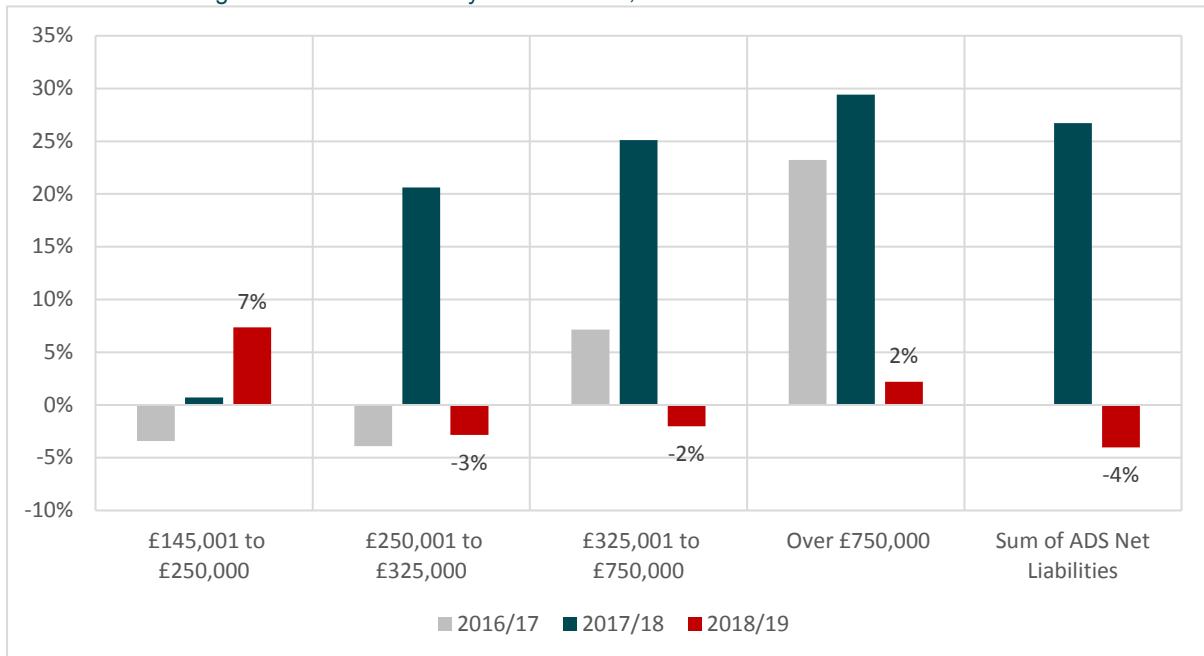
LBTT's playpark is the Scottish housing market. It particularly likes making hay in its upper slopes. When conditions are good, LBTT can run around, getting stronger and healthier. When conditions worsen, LBTT has to sit gloomy indoors.

The housing market over the 2018/19 financial year was flat. Transactions were down just -0.5% and the value of property sold (market turnover) was up slightly, by 1.6%.

As we wrote last year, LBTT's success in 2017/18 was largely down to the upsurge in demand in the higher price brackets, especially over £325,000, potentially because of the pent-up demand from the previous two years. However, the main source of market growth in 2018/19 was in the band below £250,000, which accounts for a relatively small share of LBTT revenues. Revenues in the higher

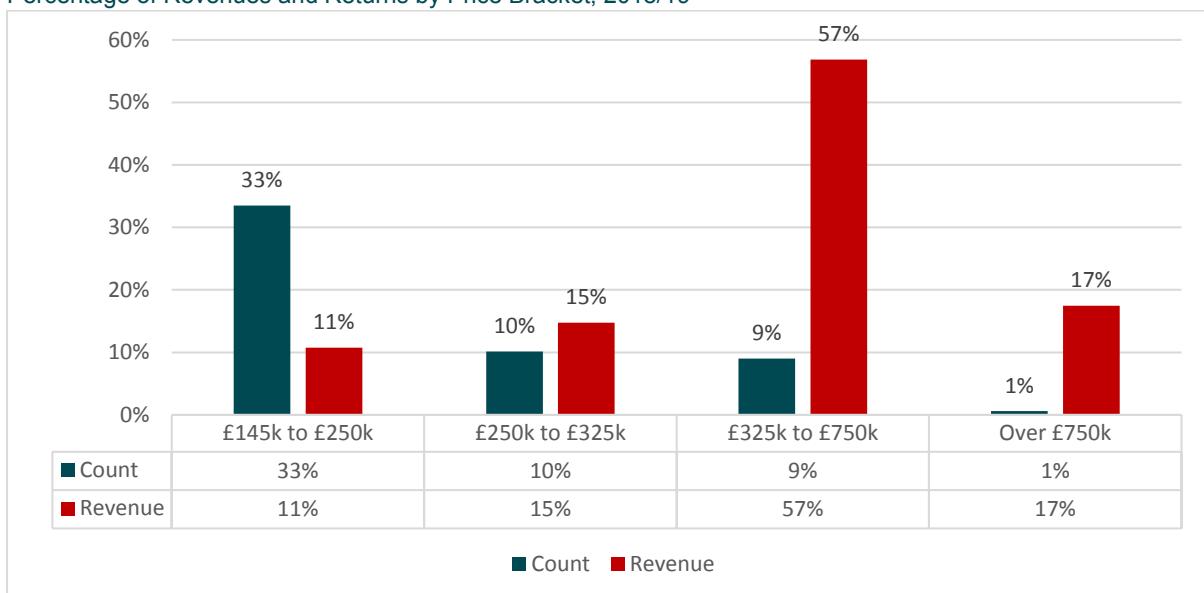
bands were flat, largely because the sales markets in these bands were flat. As nearly three-quarters of all LBTT revenues comes from the 10% of sales that occur in these higher bands, LBTT's lack of growth over the last financial year is easily explained.

Figure 3 Revenue growth halted in price brackets above £250k
Year-on-Year Change in LBTT Revenues by Price Bracket, 2016/17-2018/19



Source: Revenue Scotland

Figure 4 Three-quarters of LBTT revenue comes from 10% of transactions
Percentage of Revenues and Returns by Price Bracket, 2018/19



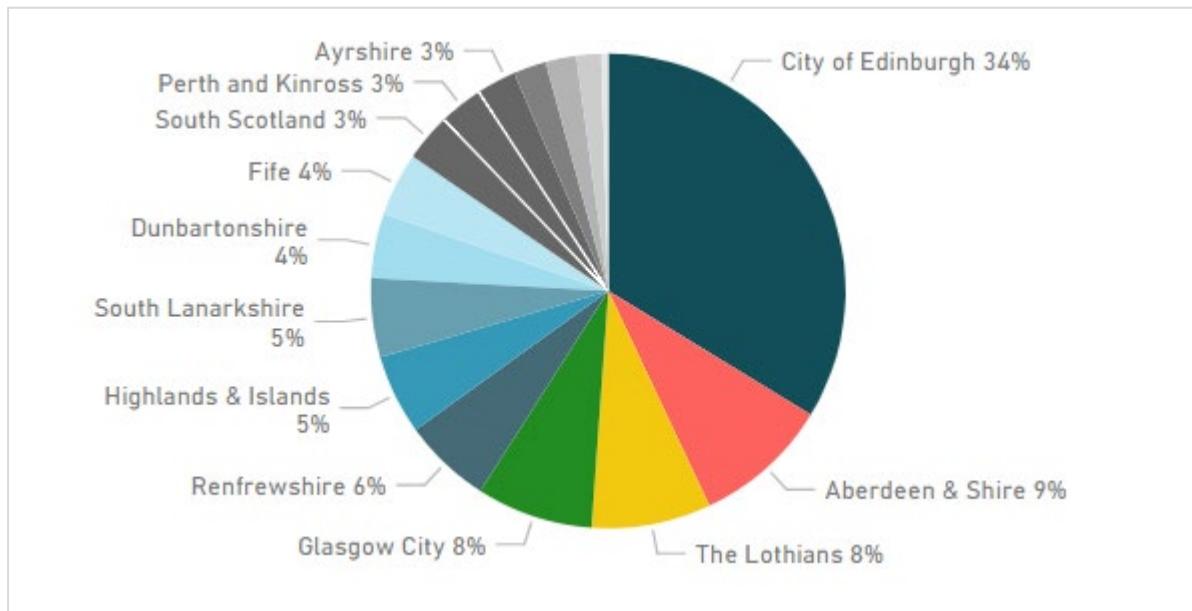
Source: Revenue Scotland

LBT'S FAVOURITE PLACE IS EDINBURGH

All 4-year-olds have a favourite place to visit, and LBTT loves Edinburgh. Over one-third of LBTT's revenues come from the City of Edinburgh council area, way ahead of any other local authority area or region. In fact, just five Edinburgh postcodes account for over 20% of total LBTT revenues across Scotland.

While Edinburgh New Town households may sometimes look on aghast at LBTT's antics, especially when they have to move house, the geographical-based nature of the tax is inevitable due to the greater onus placed by the Scottish Government in raising more revenue from higher value properties than was the case with LBTT's now deceased relative, Stamp Duty.

Figure 5 Edinburgh contributes around one-third of LBTT revenue
LBTT Revenue Origin Estimated from Registers of Scotland Sales, 2018/19



Source: Revenue Scotland

THE JOYS OF FISCAL DRAG

LBTT's favourite game is called 'fiscal drag'. It basically likes to drag reluctant people gradually into higher bands of taxation as their earnings and spending rises when there is no inflation adjustment in these bands. Over time, the tax take inevitably rises well above inflation. As house prices tend to rise inexorably over time, the Government believes that allowing LBTT to play its favourite game will earn it steadily more revenues over time as well as enhance the 'progressive' nature of the tax, i.e. those buying more valuable properties will pay a steadily greater share of the tax take over time.

How this works is demonstrated below. When LBTT was born in 2015, over half of all property transactions were exempt, but this proportion is falling and it is projected that this will only be around one-third of sales by 2023. Those in the first of the LBTT bands (£145-250k) paid around 15% of the tax in 2015, but this is projected to fall to just 8% by 2023. However, at the other end of the spectrum, those purchasing over £750,000 paid 12% of the tax in 2015, but this is projected to rise to over 21% by 2023, while still only accounting for around 1% of total sales.

Figure 6 With fiscal drag, by 2023 it is estimated that over 20% of revenue will come from 1% of sales
 Distribution of No. of LBTT Returns by LBTT Brackets (Actual and Forecast), 2015-23

	Up to £145,000	£145,001 to £250,000	£250,001 to £325,000	£325,001 to £750,000	Over £750,000
2015	52.10%	32.14%	8.61%	6.85%	0.32%
2016	52.81%	31.02%	8.42%	7.29%	0.50%
2017	49.91%	31.88%	9.39%	8.29%	0.54%
2018	47.08%	33.26%	10.04%	9.02%	0.61%
2019 Projection	44.97%	34.26%	10.59%	9.53%	0.65%
2020 Projection	44.42%	34.21%	10.98%	9.70%	0.69%
2021 Projection	43.78%	34.10%	11.22%	10.19%	0.71%
2022 Projection	40.16%	35.40%	12.12%	11.48%	0.83%
2023 Projection	37.58%	35.53%	12.75%	13.16%	0.98%

Distribution of Total Revenue by LBTT Bracket

	Up to £145,000	£145,001 to £250,000	£250,001 to £325,000	£325,001 to £750,000	Over £750,000
2015	0.00%	15.26%	17.11%	55.43%	12.26%
2016	0.00%	13.15%	14.91%	54.10%	17.74%
2017	0.00%	12.15%	14.67%	56.94%	16.29%
2018	0.00%	10.93%	14.45%	56.58%	17.93%
2019 Forecast	0.00%	11.09%	14.27%	56.77%	17.87%
2020 Forecast	0.00%	10.55%	14.24%	56.98%	18.22%
2021 Forecast	0.00%	9.65%	13.78%	57.50%	19.07%
2022 Forecast	0.00%	8.78%	12.85%	58.38%	20.00%
2023 Forecast	0.00%	7.94%	12.39%	58.55%	21.12%

Sources: Revenue Scotland/Scottish Fiscal Commission/Rettie & Co Research/Registers of Scotland

Methodology: To forecast the distribution of sales and revenue from LBTT, the residential sales for 2018 were inflated using Rettie & Co's Scottish forecasts for 2019 to 2023 and their LBTT tax liabilities calculated resulting in the distributions provided above.

WHAT NEXT FOR LBTT?

LBTT's erratic nature and failure to behave as expected is a cause of worry for its Scottish Government parents, but, to date, there has been no real chastisement or messages of 'tough love'. LBTT has largely been allowed to run around freely.

However, as it moves into its fifth year, is LBTT in need of a little more formal education? Areas for the Scottish Government to progress should include:

- **Consider adjusting the bands.** The fillip caused by the UK General Election in 2017 showed how rapidly the market can bounce on sentiment, with sales in the key LBTT price bands rising around 20-40%. By providing an actual monetary saving in moving house through adjusting the bands, the Government could stimulate the market further and create more revenue.
- **Undertake some rigorous analysis.** We estimate that with Scottish housing transactions still around one-third down on 2006/7 levels, despite rising population and household numbers, rebanding to extend the 5% band to £500,000 would push the effective tax rate above 4% from £445,000 to £590,000. Reduced transaction costs would encourage trading up, relocation and downsizing, in turn impacting on market activity across all price brackets. An increase of 20-25% in transactions above £250,000 (and a 15% increase in total transactions), still well below peak levels, would see a neutral, or small gain, in residential LBTT revenue, while reducing the burden on key buyer groups in certain geographies.
- **Be aware of the danger signs.** It is not prudent to have an important source of government income to be so narrowly based (if house sales in these parts of the market slow, the tax revenues will be seriously impacted).

So, it has been a mixed year for LBTT. The expected growth spurt has not happened and its behaviour has once again proven to be erratic, but it is still collecting the pounds and pence at similar levels to last year.

With the clouds of economic and political uncertainty now looming overhead, however, LBTT may find its play-time much more contained in 2019/20. When market conditions turn, it is usually the top end of the market that takes the sizeable hit first (as was the case in 2008/09). With a tax take concentrating ever more heavily on higher value sales in a small number of locations, the Scottish Government needs to take heed. At a minimum, some inflation adjustment of the LBTT bands is required to prevent the tax base narrowing as tightly as it is doing.