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# Supplementary Costing: Increased starting threshold for residential LBTT

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ISBN: 978-1-911637-16-5

Published by the Scottish Fiscal Commission, July 2020

Laying Number: SFC/2020/6

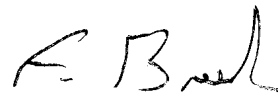
# Foreword

The Scottish Fiscal Commission is the independent fiscal institution for Scotland. Our statutory duty is to provide independent and official forecasts of the economy, tax revenues and social security spending to inform the Scottish Budget. This report sets out our costing of the Scottish Government's policy to temporarily increase the Land and Buildings Transactions Tax nil rate band to £250,000. This policy comes into effect on 15 July 2020 and remains in place until 31 March 2021. Legislation to enact this change has been introduced to the Scottish Parliament today, 15 July 2020.

Our objective is to ensure the Scottish Parliament has an independent estimate, known as a policy costing, of the effect of a policy change on revenues associated with any proposed legislation relating to taxes or benefit. As a result, we only cost policies that are announced at fiscal events or accompany legislative changes introduced in the Scottish Parliament.



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15 July 2020

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# LBTT policy costing

## Increasing the nil rate band for residential LBTT

### Introduction

- 1.1 On 15 July the Scottish Government laid in the Scottish Parliament draft legislation to temporarily increase the LBTT nil rate band for residential property transactions to £250,000, with immediate effect. The policy change applies until 31 March 2021, after which the nil rate threshold will revert to £145,000.<sup>1</sup>
- 1.2 Figure 1 shows our estimate of the effect of the policy on total LBTT revenue. The remainder of the document explains the costing in more detail.

**Figure 1: Effect of policy change on total LBTT revenue**

£ million	2020-21	2021-22	2022-23	2023-24
	-33	-15	0	0

Source: Scottish Fiscal Commission

- 1.3 This policy change has been introduced and implemented within a very short time-frame in response to the UK Government's economic update. We may further refine details of the costing, particularly around behavioural responses, in our next forecast publication. At this time initial outturn data from Revenue Scotland will be available.
- 1.4 We are using our latest February 2020 forecast, which does not factor in the COVID-19 lockdown, as the base for this costing. For the reasons set out in our April 2020 Fiscal Update, we have not yet produced an updated forecast.<sup>2</sup> According to the latest Revenue Scotland data, since our February 2020 forecast, we have seen the number of residential property transactions in April and May 2020 fall to around one-third of what we would normally expect.<sup>3</sup> We expect the number of residential property transactions to start to rise as lockdown lifts, but remain significantly lower than our February 2020 forecast of transactions for the rest of 2020-21.<sup>4</sup> Using our February 2020 forecast as the base for this policy costing means the static element of our policy costing is likely to be an overestimate.
- 1.5 We have confidence in the broad scale of the cost estimates. However, for the reasons outlined in the previous two paragraphs, our estimate of the policy cost may be subject to an abnormally high forecast error.

<sup>1</sup> For first-time buyers the threshold is £175,000 ([link](#))

<sup>2</sup> Scottish Fiscal Commission (2020) Supplementary Publication: Fiscal Update – April 2020 ([link](#))

<sup>3</sup> Revenue Scotland (2020) Land and Buildings Transaction Tax Statistics ([link](#))

<sup>4</sup> We expect the number of transactions to start to rise in the coming months as lockdown lifts without any LBTT policy change. The LBTT policy change being introduced will slightly further increase the number of transactions, which is captured in our policy costing as shown in Figure 3.

- 1.6 On 8 July 2020 the Chancellor announced changes to Stamp Duty Land Tax (SDLT) as part of the “Plan for Jobs” presented to the UK Parliament.<sup>5</sup> This policy raised the Nil Rate Band of SDLT in England and Northern Ireland to £500,000. HM Treasury published an initial cost estimate of this policy of - £3.8 billion, using the OBR’s Spring Budget 2020 forecast, which did not fully account for the effect of COVID-19. On 14 July 2020, the OBR published its Fiscal Sustainability Report (FSR) which included an estimate of the cost of this policy change based on a new central scenario which included the effect of COVID-19 on the economy and the housing market.<sup>6</sup> With the number of transactions reduced significantly in the updated FSR scenario compared to the Spring Budget 2020 forecast, the OBR’s estimate of the policy cost was substantially lower at - £1.3 billion. In broad terms, our policy costing is more similar to the HM Treasury costing, being based on an earlier forecast which does not fully include the effect of COVID-19.
- 1.7 As SDLT is devolved to the Scottish Parliament and revenue from LBTT is directly collected in Scotland by Revenue Scotland, the Scottish Government’s Budget is reduced each year based on changes in SDLT revenues in England and Northern Ireland. This reduction is known as the Block Grant Adjustment. At the UK Budget in the autumn the OBR will publish their next forecasts for SDLT revenues in England and Northern Ireland; these forecasts will take account of the circumstances of COVID-19 and the UK Government’s changes to SDLT. A revised BGA will be calculated – a reduction in SDLT revenues will increase funding for the Scottish Government. Overall we expect both SDLT and LBTT revenues to fall in 2020-21 as a result of COVID-19 and to be further reduced by the policy changes. At the current time there is significant uncertainty about the scale of the funding change for the UK Government and our forecasts provide an indication of the cost of the policy change but do not reflect the effects of COVID-19 on total revenues. The net effect on the Scottish Budget will therefore only be known once both ours and the OBR’s forecasts are revised in the autumn.

## Measure description

- 1.8 Figure 2 shows the rates and bands for residential LBTT in 2020-21 before and after the policy change. Previously, residential transactions incurred a tax of 2 per cent of the purchase price between £145,001 and £250,000. The increase of the nil rate band to £250,000 lowers the tax paid within this band from 2 per cent to 0 per cent for transactions with an effective date between 15 July 2020 and 31 March 2021. For transactions where the purchase price is above £250,000, a rate of 0 per cent applies up to £250,000, lowering the tax due, with no change to the rates and bands above £250,000. The policy change leads to a maximum reduction in tax of £2,100 per residential property transaction.

**Figure 2: Rates and bands for residential property transactions, before and after policy change**

Per cent (%)	Rates before 15 July	New rates from 15 July
Up to £145,000	0	0
Above £145,000 to £250,000	2	0
Above £250,000 to £325,000	5	5
Above £325,000 to £750,000	10	10
Over £750,000	12	12

Source: Revenue Scotland, Scottish Government

<sup>5</sup> HM Treasury (2020) Plan for Jobs ([link](#))

<sup>6</sup> Office for Budget Responsibility (2020) Fiscal sustainability report - July 2020 ([link](#))

- 1.9 The higher nil rate band applies to all buyers. The existing first-time buyer relief raises the threshold at which first time buyers pay LBTT from £145,000 to £175,000. There is no change to first time buyer relief. However, since first-time buyers will now be able to take advantage of the higher £250,000 nil rate band, no first-time buyer relief will be available while the new policy is in force. For transactions where the Additional Dwelling Supplement (ADS) applies, LBTT will not be payable on the first £250,000 of the purchase, as for all residential transactions. However the ADS will remain payable at 4 per cent of the total purchase price.

## Baseline for costing the policy

- 1.10 The baseline for costing this policy is our February 2020 forecast of residential LBTT.<sup>7</sup>

## The cost base

- 1.11 The cost base includes all residential property purchases over £145,000 taking place within the period 15 July 2020 to 31 March 2021.

## The costing

### Static costing

- 1.12 We start by estimating the number and value of transactions occurring in the period 15 July 2020 to 31 March 2021. Based on our February 2020 forecast, we estimate this to be around 79,000 transactions. We then calculate the tax that would be paid on these transactions under the new policy as compared to the current policy.
- 1.13 We account for various LBTT reliefs in our costing, as some transactions which would have been eligible for reliefs will no longer pay any LBTT. In particular, since the policy change raises the nil rate band to £250,000, no first-time buyer relief will be available while the new policy is in force.

### Behavioural effects

- 1.14 We expect the policy change to lead to a small increase in both prices and transactions in 2020-21, which will generate some additional LBTT revenues. We estimate this effect using our standard elasticities framework, which is explained in our December 2018 forecast.<sup>8</sup>
- 1.15 The policy has a fixed end date of 31 March 2021. This may induce those planning to purchase a property in 2021-22 to bring forward their transaction to 2020-21 to benefit from the policy change. Our costing accounts for this using a standard framework based on the forestalling response to historic property tax policy changes, similar to the framework set out in the OBR's working paper on property market forestalling.<sup>9</sup> We estimate that around 2,000 residential transactions will be brought forward from 2021-22. For transactions with a purchase price over £250,000, where some tax is still due, this shifting will increase LBTT revenue in 2020-21, but reduce LBTT revenue in 2021-22.
- 1.16 These behavioural responses are expected to offset a small part of the static cost of the policy change in 2020-21. Figure 3 shows the overall effect of the policy change on residential LBTT revenue.

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<sup>7</sup> Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 ([link](#))

<sup>8</sup> Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#))

<sup>9</sup> Paragraph 2.30 on page 16 of OBR (2016) Working Paper No. 10 – Forestalling ahead of property tax changes ([link](#))

**Figure 3: Effect of policy change on residential LBTT revenue**

£ million	2020-21	2021-22
<b>Static cost</b>		
Effect of raising threshold	-60	
Saving from first-time buyer relief	5	
Saving from other reliefs	2	
<b>Behavioural response</b>		
Price effect	4	
Transaction effect	3	
Forestalling	6	-10
<b>Total cost</b>	<b>-39</b>	<b>-10</b>

Source: Scottish Fiscal Commission  
 Figures may not sum because of rounding.

### Additional Dwelling Supplement

**1.17** Purchases where ADS is due will continue to pay the normal rate of ADS so there is no direct effect on ADS revenue. However, since these transactions will benefit from the lower LBTT rate, in the same way as non-ADS transactions, it is likely that the transactions brought forward from 2021-22 to 2020-21 will include some ADS transactions. We estimate that of the 2,000 residential transactions brought forward into 2020-21, around 400 will pay the ADS.

**1.18** Around 26 per cent of ADS paid will later be reclaimed by buyers who subsequently sell their previous main residence. ADS can be reclaimed providing the sale takes place within 18 months of the original ADS transaction. Based on our estimate of the ADS repayment profile, ADS transactions that are brought forward from 2021-22 to 2020-21 will continue to have a small effect on the amount of ADS reclaimed into 2023-24.

**1.19** Figure 4 shows the effect of behavioural responses to the policy on ADS revenue.

**Figure 4: Effect of behaviour on ADS revenue**

£ million	2020-21	2021-22	2022-23	2023-24
Gross ADS	8	-5	0	0
Repayments	-1	0	0	0
<b>Net ADS</b>	<b>7</b>	<b>-5</b>	<b>0</b>	<b>0</b>

Source: Scottish Fiscal Commission  
 Figures may not sum because of rounding.

### Uncertainty

**1.20** The two largest sources of uncertainty in this costing come from using our February 2020 forecast as the base, and our estimate of the forestalling response.

**1.21** Using our latest February 2020 forecast, which does not fully include the effects of COVID-19 and therefore projects a higher level of transactions for this year as a whole than now appears reasonable, means the static element of our costing is likely to be an overestimate. The static



element of the costing depends on what would have happened to residential property transactions over the rest of 2020-21 without the policy change. On the one hand, we expect the COVID-19 lockdown and resulting economic recession to continue to suppress the number of transactions, and our baseline of 79,000 transactions occurring in the rest of 2020-21 is likely to be too high. On the other hand, as the lockdown lifts and economic activity resumes, the number of transactions will start to rise, and there may be some additional transactions in the second half of 2020-21 delayed from the first half of the year. Our static costing is more likely to be too high than too low, but overall our judgement is that it remains a reasonable estimate.

- 1.22 Forestalling responses are highly context dependent and uncertain, and previous forestalling examples may not be a good guide to the forestalling response to this policy change. We have previously seen strong forestalling responses in the Scottish property market in response to changes in LBTT policy. On the other hand, while there is clearly a strong incentive to bring forward property transactions from 2021-22, there will be limitations on the ability of buyers to bring transactions forward because of lockdown and the economic recession. For example, some buyers may struggle to get access to credit for a purchase in 2020-21, and there may be some limit on the total number of properties coming to the market for sale as sellers may also be concerned about buying their next property. Uncertainty over the forestalling response affects tax revenue estimates in both 2020-21 and 2021-22.

# Additional information

## Abbreviations

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ADS	Additional Dwelling Supplement
FTB	First Time Buyer
LBTT	Land and Buildings Transaction Tax
OBR	Office for Budget Responsibility
SEFF	Scotland's Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission

A full glossary of terms is available on our website:

<http://www.fiscalcommission.scot/about-us/glossary-of-terms/>

## Code of Practice for Statistics

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The Commission seeks to adhere to the highest standards for analysis possible. While we do not produce official statistics (we produce forecasts), the Commission and our work voluntarily complies as much as possible with the UK Statistic Authority's Code of Practice for Statistics. Further details and our statement of voluntary compliance can be found on our website.

## Correspondence and enquiries

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ISBN: 978-1-911637-16-5

Published by the Scottish Fiscal Commission, July 2020