The Additional Dwelling Supplement

The LBTT Additional Dwelling Supplement – Note for the Scottish Parliament's Finance Committee Round-table discussion on 29 May 2019 by the Scottish Property Federation

Introduction

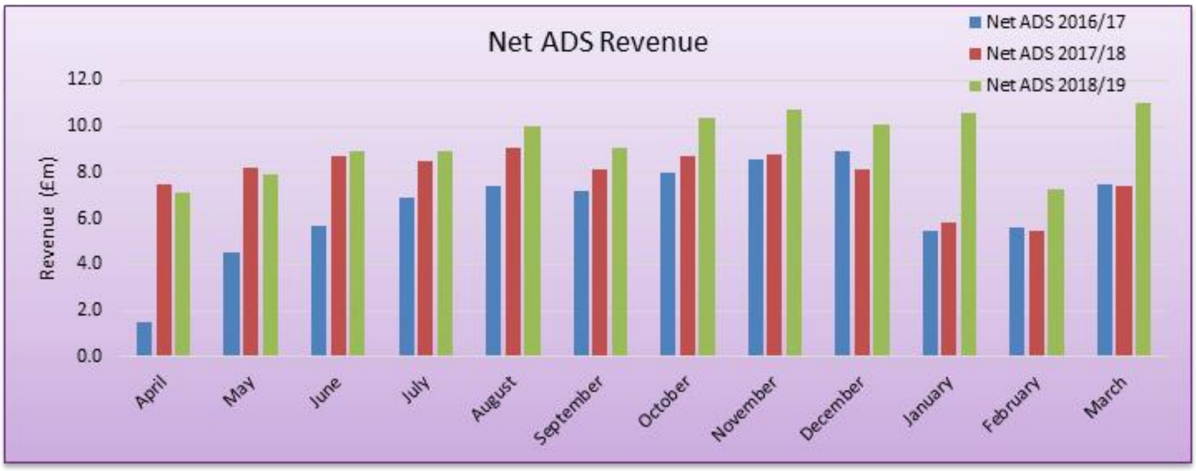
1. We welcome this opportunity to contribute to the Finance Committee's round-table discussion on the impact and implementation of the LBTT Additional Dwelling Supplement.

2. The Scottish Property Federation (SPF) is a voice for the real estate industry in Scotland. We include among our members: property investors, including major institutional pension and life funds; developers; landlords of commercial and residential property; and professional property consultants and advisers. In total we number over 185 businesses and organisations with Scottish real estate industry interests.

3. The SPF recognises that ADS has become a significant component of LBTT revenue for the Scottish Government and therefore the delivery of public services. Indeed, without ADS outperforming government expectations for 2018-19 (ADS is currently some £18mn above forecast revenue), the outturn for LBTT revenue in 2018-19 (as reduced in the December 2018 budget statement) would not have been achieved.

4. The recent decision to increase the rate to 4% in January appears to have been absorbed by the market and we acknowledge that ADS revenues have been strong since October 2018, with the exception of February 2019. Some caution should be applied to the current net revenue however because taxpayers have 18 months to seek repayments of ADS, so it is expected that the figures reported below will be reduced as repayments are made. Indeed, we estimate that so far in 2018-19 just 16% of ADS has been reclaimed, which suggests that a further 10% is yet to be claimed by taxpayers.

Net ADS Revenues – 2016-19 (Provisional)



Implementation of LBTT ADS

5. The ADS was devised and introduced in a very short period of time, between late December 2015 and end February 2016. Because of the nature of the existing LBTT Act, it was necessary to introduce an entirely new Act in order to introduce the new tax supplement. We believe this led to hasty legislation and consultation, which we would argue was not ideal for the process of scrutiny

by either parliament, government experts or stakeholders, and we believe the consequences may still be discerned in the market today.

6. The ADS was introduced as a slab tax and runs contrary to one of the founding principles of LBTT which is that it should be progressive. We recognise that the tax is intended to apply to taxpayers *able* to afford a second dwelling, yet we believe the decision to base the tax on the whole consideration of the transaction undermines the widely respected move to a progressive 'slice' structure, which was deemed to be proportionate. This means that the recent increase to 4% was significantly greater than had it been based on a slice tax structure.

7. Several of our legal members also report that unless a transaction that may involve ADS is very straightforward then the regulation around ADS remains very complex. Our members report that even now, several years after the introduction of the tax, the experience of taxpayers is often one of significant uncertainty on whether they are liable or not for the tax and second, considerable inconvenience.

8. The costs of the ADS supplement are often significant and, although we estimate that annually some 25% of ADS is now repaid to taxpayers, there is nonetheless a significant up-front financial cost. The high levels of repayment bring us to the conclusion that the tax is inefficient, if a quarter of its revenue subsequently has to be repaid, potentially over an 18-month period.

Impacts on the housing market

9. The recent increase in the rate of ADS did appear to lead to a short-term period of forestalling, which is difficult to attribute to anything other than the change in rate. A sudden increase of 650 ADS transactions during January 2019 was subsequently followed by a year-on-year fall of 170 in February 2019 and then again in March with a year-on-year fall in transactions of 100. However, early indications are that in April the market had adjusted its activity levels.

10. The table below represents our analysis of comparative ADS transactions from November 2017-18 to April 2018-19.

Month	**Number of ADS Notifiable Transactions**	**Month**	**Number of ADS Notifiable Transactions**	**Difference**
Nov-17	2,110	Nov-18	2,250	140
Dec-17	1,990	Dec-18	2,050	60
Jan-18	1,430	Jan-19	2,080	650
Feb-18	1,370	Feb-19	1,200	-170
Mar-18	1,790	Mar-19	1,690	-100
Apr-18	1,810	Apr-19	1,970	160

11. The impact of tax changes should rarely, if ever, be seen in isolation. There are many other factors which influence the markets and ADS is no exception to this premise. We have seen changes in financial policy that have made the Buy-to-Let sector look less attractive, including reduction of

mortgage relief and changes to Tenancy legislation which have arguably shifted the balance of risk more towards the landlord.

12. Perhaps the best indicator of impact on the buy-to-let market is the fall in mortgage approvals for the purposes of buy-to-let. In addition, new affordability has been introduced for lending to the buy-to-let sector. One measure that can be made of the activity of buy-to-let activity is to look at its proportion of the total mortgage lending activity that is produced by the Financial Conduct Authority. These are UK-wide figures but from an average percentage of around 16% of mortgage loans made in 2016, buy-to-let has fallen to representing around 12.5% of mortgage loans in 2019. Over the same period lending to first-time homebuyers has gradually increased across to over 21%. This data – albeit UK-wide - may support the proposition that the policy of a Supplement on 'second-home owners' has enabled more properties to be accessible to aspiring homeowners, but it should be added that other policy initiatives will have played a part in improving access to homes for first-time buyers.

Unintended consequences

13. The combination of the measures that have come to affect landlords, the ADS charge, changes to mortgage interest relief, affordability rules and tenancy reform, is a significant change to the attractiveness of the market for landlords. Should the fall in lending to the Buy-to-let sector crystallise into a fall in supply, we may see rents increase if demand continues to be strong. This would not just increase rental levels in particular locational hotspots, but if supply becomes more constricted then it could potentially reduce choice and availability at a time when the demand for private rental accommodation, from both individuals and families, has grown.

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