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Subject: Ex-ante advice on the classification of Her Majesty's Land Registry

Reference: Your letter of 26 June 2018, case 2017-90
Our discussion of 25 September 2018
HMLR letter of 26 September 2018

Dear Mr Bailey,

Thank you for your ex-ante advice request on the classification of Her Majesty's Land Registry (HMLR) dated 26 June 2018 and the discussion on 25 September 2018. After having closely examined the arguments in the documentation provided, Eurostat is now in a position to express a view on this matter.

1. THE CLASSIFICATION ISSUE

The issue, initially discussed during the Standard Dialogue Visit in May 2017, is to analyse the decision taken by the Economic Statistics Classification Committee (ESCC) of the ONS concerning the statistical classification of HMLR, designated as a trading fund. This decision has been questioned by the board of the HMLR. Therefore, the Office for National Statistics requests Eurostat's opinion on the three following issues, whether:

- The charges on confirmation statements and incorporation levied by the HMLR should be considered as compulsory and unrequited and therefore as taxes;
- The revenue earned by the HMLR, if considered as market sales of a service, would not be considered economically significant;
- The activity of the HMLR should not be considered as a regulatory activity.

It is generally admitted, that the HMLR is an institutional unit under government control satisfying the conditions set in ESA 2010 2.12 and 20.309. HMLR is a profit making unit, which distributes its dividends to the owner (government) and therefore cannot be considered as a non-profit institution (ESA 2010 3.31).

Documentation provided

The ONS provided to Eurostat a copy of the following confidential documents:

- Classification case from ONS (case 2017-70) and supporting documents
- Documents and arguments provided by HMLR

2. DESCRIPTION OF THE CASE

HMLR is a non-ministerial department and executive agency. This status entails carrying out executive functions within government and with a specific focus on delivering a specified output. It is currently sponsored by the Department for Business, Energy and Industrial Strategy. It has been granted the status as a trading fund with the aim of financing revenue generating operations and to engender a more commercial approach.

The primary role of HMLR is to provide:

- a reliable record of information about the ownership of and interests affecting land and property;
- land and property owners with a legal title which is guaranteed by government, and;
- the financial sector with a better secured legal environment when lending against a registered property, compared to lending against a non-registered property.

In addition, HMLR states as its ambition "*to become the world's leading land registry for speed, simplicity, and an open approach to data*" by "*maximising the use of our data for the benefit of wider society and to drive innovation in the digital economy*". HMLR also aims to "*revolutionise the property market*" and to "*create an unrivalled source of geospatial intelligence for the nation*". HMLR's performance report also explains how its role makes it a "*critical component of national infrastructure*", and how HMLR intends to "*shape the future of the property and financial markets*" and "*promote benefits that help tackle economic, social and environmental issues*".

Registration is compulsory with HMLR if a property is bought / sold, has been given, inherited, received in exchange for another property or mortgaged.

HMLR provides to the property owner the guarantee of his ownership title and is accountable for any error in the register and has to indemnify with its own funds, backed by a government guarantee, for any such error. Although the registration of any property transfer is compulsory, no penalties or legal actions are included in the law. However, in the case of non-registration, the property owner will have only an uncomplete legal title of his property and might face difficulties to receive any mortgage loan from a financial institution.

As property registration is compulsory, the whole economy can rely on the quality and the legal robustness of the framework and therefore the land register provides legal security not only to the owner but to the whole economy by the property registration system.

2.1. Funding of HMLR

A majority of the HMLR revenues comes from the registration of property titles (> 66% of revenues in 2016/17). Prices are fixed to cover HMLR's expenditure plus a limited margin as a return on capital employed. Any dividend capital realised by HMLR shall be paid out of the trading fund to the consolidated fund held with the Treasury. The level of the registration fees are proposed by HMLR, but have to be approved by the Secretary of State.

Payments due are calculated in consideration of the property value by tranches, although the work carried out seems to be very similar for each property registered whatever the market value of the property is. HMLR distinguishes between the first registration of a property without a sale (the payment due is assessed by considering the market value of the property) or a sale (payments due are set against the transaction price of the property).

2.2. Regulatory activity

HMLR registers the property by assessing the documents provided by the buyer or the beneficiary of a property transfer and the documents already registered. In counterpart, the owner of the property receives a confirmation of the property title and benefits from the state-backed guarantee. In addition, the registration benefits not only the owner, but also the whole economy e.g. households, financial institutions and businesses. To that extent, HMLR activity might be considered as regulatory, although there is no activity directly described in either ESA 2010 or in the MGDD 2016. As a result the status as a regulatory body can be questioned.

It could be questioned whether an assessment of provided documents can be considered as a regulatory activity. Furthermore, the payments due for the delivery of the property title are assessed not in relation to the cost of the individual assessment, but in relation to the value of the property registered.

3. METHODOLOGICAL ANALYSIS

Classification decision of the Economic Statistics Classification Committee (ESCC)

The ESCC reached the conclusion that:

- HMLR has to be considered as an institutional for profit unit under public control;
- Revenues received HMLR should be considered as compulsory and un-requested and therefore as taxes;
- The activity of HMLR cannot be considered as a regulatory activity.

Therefore, the ONS concluded that HMLR should be classified in the general government sector (S.13).

Applicable accounting rules

Based on the documents provided, Eurostat carried out its analysis on the three issues raised by the ONS, considering ESA 2010, in particular Chapters 3, 4 and 20, as well as the Manual on Government Deficit and Debt (MGDD 2016) in particular the Chapter I.2 and I.6.

Analysis

3.1. HMLR being a market regulatory body?

HMLR is an executive agency in charge of the registration of all land and real-estate property, which is bought / sold, has been given, inherited, received in exchange for another property or mortgaged.

The MGDD 2016 I.6.5.1 §30 states:

"Market regulatory bodies (also named authorities, agencies, regulators, etc.), described in this chapter, are entitled by law with the powers to elaborate some regulations (norms, provisions, obligations, etc.). These regulations are legally binding and any actor on the market for a given activity is obliged to follow them, at the risk of possible prosecution (sanctions). Thus, market regulatory bodies exert decision-making on some key variables, influencing the way in which units carry out an activity and receive revenue from it."

In contrary to the foregoing, HMLR is not entitled to set compulsory regulations for property registration. It implements the regulatory decisions of the UK government and / or Parliament and assesses the property transfer documents against legal requirements. Although registration of any property being the subject of any transaction is compulsory, any non-observance of this obligation gives no raise to sanctions, prosecution or fines.

In addition I.6.5.1 §31 of the MGDD 2016 specifies, that:

"Market regulatory bodies may also be responsible for controlling norms, although this task could be delegated to a specialised unit without normative powers. In addition, market regulatory bodies may also exert ex-ante control on the agents wishing to take part in an activity in order to assess their competence, professional capacity (licenses, permits to operate) and provide some assurance to consumers on the professional expertise and qualification of the professional category (doctors, lawyers, etc.). [...]"

The activities of HMLR can be described to some extent as regulatory, however, the control element seems limited to controlling the correctness of the documents provided. There is no ex-ante control of the capacity or the professional expertise of any agent linked to the registered property. HMLR issues, after having assessed the correctness of the documents and the content, the property title. However, the benefits are not limited to the owner of the property and fee paying individual or corporate, but to the whole economy by guaranteeing a secured legal environment. Finally it is doubtful that the payments to HMLR can be considered as proportional to the service rendered, as the fee calculation is based on the property value (market or transaction value) but not on the cost of assessing the documents.

3.2. HMLR revenues being taxes or sales?

Taxes are defined as compulsory and unrequited levied by government on individuals or corporations (ESA 2010 4.77, 4.79 (d) and 20.165). They are compulsory because being due by each individual or corporation or at least by a defined group of individuals fulfilling certain conditions or willing to exercise a specific activity. They are unrequited as government does not deliver a specific service in line with this specific tax.

The MGDD 2016 I.2.4.8 specifies the borderline between taxes and sales of services:

"In assessing whether a unit is market or non-market, it is necessary to check whether a unit's income from non-government sources should be classified as sales or as something else. For example, payments made for permissions to carry out a given business or personal activity (usually evidenced by a license), should be treated as sales of services only if the revenue is used to organise some proper regulatory function associated with the permission (such as checking the competence or the qualification of the person concerned, suitability or safety of the business premises, reliability or safety of the equipment employed, quality or standard of goods and services produced), and if the payments do not significantly exceed the cost of providing the services. However, the degree of obligations for the payers should also be considered, as there may be situations where the economic agents cannot carry out a given activity without holding a specific permission, so that the price should in no way influence the number of bid and asked permissions. Such payments should be treated as taxes if either of those conditions is not satisfied (see ESA 2010 4.79 (d)) and, therefore, the unit classified within general government or, in some cases, the payments rerouted via government since only government has the power to levy taxes."

HMLR registers all transfers of properties, issues the corresponding property title and guarantees the owner against any error in the registration process or outcome with its own funds backed by a government guarantee.

The registration of any property change is compulsory by law. Therefore every single land or property owner has to comply with the registration obligation, although no sanction is included in the law if the owner does not comply with this obligation. Therefore, the payments to HMLR have to be considered as compulsory.

In order to assess whether the payments are required or unrequired, it is necessary to analyse the counterpart received by the property owner. The owner receives by registering his property a legal title, proving his ownership, opposable to third parties. However, the owner is not the only beneficiary of the registration of the property. Any financial institution benefiting from any mortgage on the property sees his rights guaranteed in the same way. In addition, by registering, if not all, but a large majority of properties, HMLR participates in delivering a service to the public in general by guaranteeing a secured system of ownership and properties, what is also stated in its strategic report and the performance report. As a consequence, the fee paying individual cannot be considered as the sole beneficiary of HMLR's services.

A further aspect is implied by the guidance given by ESA 2010 4.79 (d), completing the provisions set in ESA 2010 4.23, considering the payments for licences:

"[...] if the issue of licenses involves little or no work on the part of government, the licences being granted automatically on payment of the amounts due, it is likely that they are simply a device to raise revenue, even though the government may provide some kind of certificate, or authorisation, in return; in such cases their payment is treated as taxes. If, however, the government uses the issue of licences to organise some proper regulatory function (such as checking the competence, or qualifications, of the person concerned), the payments made are treated as purchases of services from government rather than payments of taxes, unless the payments are clearly out of all proportion to the cost of providing the services;"

Although the activity of HMLR does not coincide with the narrow definition of the regulatory function, the HMLR activity seems to have a regulatory aspect by assessing the property transfers. Nevertheless, the calculation of the payments due is based on the value of the property registered and clearly not linked to the work carried out by HMLR to assess the documents

provided. As an example the payment for the transfer of ownership of a property of £ 1.0 million is set at £ 540, whereas the payment due for a transfer value of £ 1,000,001 is set at £910. Therefore it should be concluded that the payments due cannot be considered as proportional to the work carried out. In addition, it can be concluded that the charges include a distributive effect due to the applicable payment levels.

A final aspect is that HMLR has an artificial monopoly, created by law, over the registration of properties, which makes registration compulsory. The compulsory element of the charges due to the monopolistic position of the HMLR and the tight link between the charges and the role of the HMLR points also to recognising the fiscal nature of the charges in national accounts.

Thus, at least the majority of HMLR revenues should be considered as taxes, not as sales of services, and not being included in the calculation of the market / non-market test (ESA 2010 20.30 – 31).

3.3. Should the payments made to HMLR be considered as economically relevant?

The third aspect is to determine whether the prices charged can be recognised as economically significant. ESA 2010 3.19 defines the notion of economically significant prices:

"Definition: economically significant prices are prices that have a substantial effect on the amounts of products that producers are willing to supply and on the amounts of products that purchasers wish to acquire. Such prices arise when both of the following conditions apply:

- (a) the producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and*
- (b) consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged.*

ESA 2010 20.23 gives the guidance on economically significant prices when output is sold to households and corporations:

"Economically significant prices normally result when two major conditions are fulfilled:

- (1) The producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other production costs, including consumption of fixed capital, by sales; and*
- (2) Consumers are free to choose on the basis of the prices charged."*

And the MGDD 2016 I.2.4.1 gives further indications:

"ESA 2010 states that the distinction between market and non-market producers depends on whether or not prices charged for sales of goods and services are economically significant (see ESA 2010 20.19 and following paragraphs). A price is said to be economically significant when "it has a substantial influence on the amounts of products the producers are willing to supply and on the amounts of products that the purchasers wish to acquire." The capacity of producers and consumers to react to economic "signals" is fundamental as to assess market behaviour. Conversely, a price is said to be not economically significant when it has little or no influence at all on how much the producer is prepared to supply and have

only a minor influence on the quantities demanded. It is thus a price that does not determine the observed levels of supply or demand."

The determination of the prices charged by HMLR is based on an expected cost calculation plus a margin representing the remuneration of the share capital. It is questionable whether HMLR is able to fix freely the prices directly. The prices charged by HMLR are set through at least secondary legislation by the Secretary of State and are governed by a legislative framework.

HMLR might have an incentive to adjust supply with the objective to cover production costs and to meet the annual objective of a return on capital of 3.5%. However, owners are not free to choose on the prices charged when registering the transfer of ownership of any property as they are required by law to deliver regulatory information and pay the relevant charge. Finally the payments seem not to be linked to the volume of output value, as those are fixed for the delivery of the registration. In addition, the demand for registration will not depend on the prices charged but on the economic interest of the buyer to invest in land or a real-estate property. The associated cost of the registration will have almost no influence on the acquisition decision. As a consequence of the aforementioned, the demand for HMLR services appears being not linked to the prices charged. In contrary to other services delivered to businesses and households for a limited cost compared to the main transaction (i.e. stamps), there is no alternative to the property registration. As a consequence, prices charged by HMLR should not be considered as economically significant.

4. EUROSTAT'S VIEW

Eurostat agrees with the ONS analysis:

- that HMLR cannot be considered as a regulatory body, although carrying out some regulatory activity in a broad sense, because HMLR requests levies out of proportion compared with the work carried out (MGDD 2016 I.6.5.1),
- that the payments made to HMLR should be considered, as taxes (ESA 2010 4.23 and 4.79, MGDD 2016 I.2.4.8), because the payments have to be considered as compulsory and not required.

In addition Eurostat considers that the prices charged by HMLR could not be considered as economically relevant (ESA 2010 3.19 and 20.23, MGDD 2016 I.2.4.1), because they do not have any influence on the demand of HMLR's services and no alternative solution is proposed to register any real-estate property.

As a consequence, Eurostat agrees with the ONS that HMLR should be classified within the general government sector (S.13).

5. PROCEDURE

This view of Eurostat is based on the information provided by the UK authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC.

Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on its website.

Yours sincerely,

(e-Signed)

Luca Ascoli
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