LAND AND BUILDINGS TRANSACTION TAX (SCOTLAND) BILL

POLICY MEMORANDUM

INTRODUCTION

1. This document relates to the Land and Buildings Transaction Tax (Scotland) Bill as introduced in the Scottish Parliament on 29 November 2012. It has been prepared by the Scottish Government to satisfy Rule 9.3.3(c) of the Parliament’s Standing Orders. The contents are entirely the responsibility of the Scottish Government and have not been endorsed by the Parliament. Explanatory Notes and other accompanying documents are published separately as SP Bill 19–EN.

POLICY PRINCIPLES OF THE BILL

General overview

2. The Land and Buildings Transaction Tax (Scotland) Bill is the first of three related Bills being brought forward as a consequence of measures enacted in the Scotland Act 2012 (“the 2012 Act”) which received Royal Assent on 1 May 2012. Under the terms of the 2012 Act, the Scottish Parliament will have responsibility for taxes on land transactions and disposals to landfill. This Bill deals with the former responsibility and makes provisions for a Scottish tax on land transactions, to be called the Land and Buildings Transaction Tax (“LBTT”). The intention of the UK Government is that the provision in the 2012 Act disapplying the UK Stamp Duty Land Tax (SDLT) regime to Scotland will be brought into force with effect from the end of March 2015 by a Treasury Order in the UK Parliament. To ensure consistency of tax revenues to government, it is intended that the legislative provisions for LBTT will come into force the day after SDLT is disapplied. The Scottish Government is also consulting on a Scottish tax on disposals to landfill and will bring forward a Landfill Tax Bill in due course. The UK Government will make a reduction to the Scottish block grant (the annual grant paid to the Scottish Government) to offset the expected income from the two devolved taxes so that the Scottish Government’s budget will remain broadly as it would have been.

3. It will be important that, during the transitional period when SDLT is withdrawn and LBTT is introduced, it is clear, particularly in relation to leases, which tax is due and when. There are transitional rules in section 29(6) of the 2012 Act and the UK Treasury is empowered to make consequential and transitional amendments in respect of the new regime by order under section 42(3) of the 2012 Act. The Scottish Government will liaise closely with the UK Treasury to ensure that the arrangements for the transitional period work effectively.
This document relates to the Land and Buildings Transaction Tax (Scotland) Bill (SP Bill 19) as introduced in the Scottish Parliament on 29 November 2012

4. The Bill makes provision for Scottish Ministers to be the Tax Authority but for the Authority to be changed by order. As indicated in a statement to the Parliament on 7 June 2012 by the Cabinet Secretary for Finance, Employment and Sustainable Growth, a new body, Revenue Scotland, has been established as an administrative function within the Scottish Government. The Government will shortly consult on provisions to establish Revenue Scotland on a statutory footing. It is intended that the administration and collection of LBTT will be undertaken by Registers of Scotland (RoS) on behalf of Revenue Scotland.

5. In his statement, the Cabinet Secretary also said that the Scottish Government’s approach to taxation in general, and to LBTT in particular, would be founded on four principles – certainty, convenience, efficiency and proportionate to the ability to pay. The Scottish Government has taken care to ensure that these principles are reflected throughout the provisions in this Bill. LBTT will deliver certainty because it has been designed to be as simple as possible and to better reflect Scots law and practice. It will deliver convenience because collection will be supported by a modern, electronic payments system, in line with the ambitions set out in Scotland’s Digital Future: A Strategy for Scotland.¹ It will deliver efficiency because LBTT will be collected by Revenue Scotland through Registers of Scotland, drawing on all of its existing relevant knowledge and expertise. It will be proportionate to the ability to pay because LBTT will have a progressive structure so that the amount of LBTT paid will relate more closely to the value of the interest in the property acquired compared to SDLT.

6. LBTT will result in tax revenue that will be used to further the Scottish Government’s purpose – to create a more successful country with opportunities for all of Scotland to flourish, through increasing sustainable economic growth. In keeping with these ends, this Bill provides for a tax which:

- Is expected to come into effect on 1 April 2015;
- Is modern, efficient, and progressive;
- Does not impede or distort legitimate commercial or housing-market activities;
- In the interests of simplicity, reduces the number of tax reliefs available;
- Is better aligned with Scots law and practices; and
- Contributes revenues to support Scotland’s public finances.

7. In order to prepare for the efficient management of LBTT - and to make provision for any further taxes which could be devolved in the future - arrangements need to be made for the administration and prompt collection of the tax to ensure compliance, and for appeals. Many of the legislative requirements in relation to collection, compliance and appeals will be common to the proposed tax on disposals to landfill and to any further taxes devolved to Scotland in future, as provided for in the 2012 Act. To keep these common provisions in one place and, where possible, promote simpler and more user-friendly tax legislation, a further Bill (which may be called the Tax Management Bill), will be brought forward in 2013 and will, subject to Parliamentary approval, establish the overall framework for tax administration in Scotland. The Scottish Government intends shortly to consult on provisions for inclusion in the Tax Management Bill.

¹ http://www.scotland.gov.uk/Publications/2011/03/04162416/0
8. The LBTT Bill and the Tax Management Bill should, therefore, be viewed as a package, with the LBTT Bill setting out the rules and structure for the tax itself and the Tax Management Bill providing for the issues that are common to both LBTT and to the proposed Landfill Tax, such as the powers of Revenue Scotland, the obligations of taxpayers, the treatment of taxpayers who fail to comply, how taxpayers can appeal, and the treatment of taxpayer information.

9. Revenue Scotland will delegate the day-to-day administration and collection of LBTT to RoS. RoS already performs a key role in many land transactions in Scotland by managing the land registration process and also by collecting SDLT on behalf of HM Revenue & Customs (HMRC) in certain cases. Joining RoS’ existing responsibilities together with a new role in collecting LBTT will enable taxpayers to submit their tax return and their applications to register title at the same time and to pay their tax and registration fees in one process.

10. The Scottish Government is committed to fostering improvements in public services and to promoting innovation and creativity by engaging with stakeholders, expert practitioners, and representative organisations to draw on their in-depth knowledge and experience to inform policy development. To this end, the Scottish Government is committed to consulting on devolved taxes. The consultations cover, respectively, LBTT (consultation launched on 7 June 2012 and closed on 30 August), Landfill Tax (consultation launched on 25 October 2012 and scheduled to close on 15 January 2013) and Tax Management (consultation due mid December 2012 until spring 2013).

11. Details of the analysis of the LBTT consultation responses are provided at paragraph 18 below.

**Provisions of the Bill**

12. The Bill provides for the rules and structure of LBTT which will impose a tax on anyone buying, leasing or taking other rights (such as options to buy) over land and property in Scotland. LBTT will cover both residential and non-residential transactions. To broaden the tax base, in distinction to the position for SDLT, licences to occupy property are not exempt interests and will be subject to LBTT if there is chargeable consideration that exceeds the nil rate band to be prescribed in due course. Non-residential transactions include:

- The purchase, lease or licence of, or purchase of an option over, commercial property (e.g. shops, offices, factories, hotels, etc.);
- The purchase, lease or licence of, or purchase of an option over, land for development (e.g. for housing, commercial properties, wind farms, etc.);
- The purchase, lease or licence of, or purchase of an option over, agricultural land;
- The purchase, lease or licence of, or purchase of an option over, forestry land;
- Purchases and leases for sports, such as salmon fishing; and
- Other interests in land such as the grant of liferents or servitudes.

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2 Link to consultation paper [http://www.scotland.gov.uk/Publications/2012/06/1301](http://www.scotland.gov.uk/Publications/2012/06/1301)

3 Link to consultation paper [http://www.scotland.gov.uk/Publications/2012/10/3524](http://www.scotland.gov.uk/Publications/2012/10/3524)
This memorandum deals with the following main issues:

- How the tax will be administered, including tax returns and payment arrangements;
- How the tax will be structured by reference to tax rates and bands (although actual tax rates and bands will be set nearer April 2015 by subordinate legislation made under this Bill, in association with the relevant budget);
- The Scottish Government’s approach to tax avoidance in relation to LBTT;
- ‘Notifiable’ transactions and those that will be exempt from LBTT;
- Transactions that will be entitled to a full or partial relief from LBTT;
- Calculation of tax for residential and non-residential leases; and
- Arrangements for transactions involving companies, trusts, and partnerships.

14. In May 2012, the UK Government launched a consultation on a new annual charge on homes worth over £2 million held by companies, partnerships and collective investment schemes. It also plans to consult on draft legislation between December 2012 and February 2013. The proposals, which may be introduced in the UK Finance Bill 2013, are entirely separate from LBTT. If introduced, the annual charge would apply in Scotland, but the tax revenue would not accrue to the Scottish Government and the Scottish Government would have no control over the tax since it would not be a devolved tax.

**Alternative approaches**

15. The first potential option is to ‘do nothing’ – i.e. do not replace SDLT once it is disapplied in Scotland at the end of March 2015. This would mean that from April 2015 taxpayers would no longer need to pay tax on land transactions in Scotland. However, as there would still be an adjustment in the Scottish block grant payment to reflect the fact that responsibility for the SDLT replacement tax has been devolved to the Scottish Parliament, such an option would result in a material reduction in the block grant. That would damage public services in Scotland.

16. The second option is to provide for a replacement tax, for which Scottish legislation is needed. Under the terms of the 2012 Act, SDLT will be disapplied in Scotland by Treasury order; the UK Government’s policy is that this will take place from April 2015. The disapplication of SDLT and consequent introduction of LBTT are not linked to other constitutional initiatives, such as the referendum on independence scheduled for the autumn of 2014. There are no other practical options.

17. Some of the provisions in the Bill are intended to replicate the effect of parts of the existing SDLT legislation. In other areas, the Scottish Government has decided to make changes which it believes will serve better the interests of the people of Scotland. In all instances where a policy decision was required, either to replicate or to change an element of the existing system, careful consideration was given to the policy alternatives and a decision was made on the basis of the available evidence. At the appropriate points, this memorandum makes reference to these alternative approaches and explains why the Scottish Government has reached the decision that it has.
CONSULTATION

18. As mentioned above, discussion and debate on the provisions of this Bill began with the publication of a consultation document, *Taking forward a Land and Buildings Transaction Tax*\(^4\), on 7 June 2012. The consultation document included 17 questions, as follows:

- Questions 1-8 covered the proposed structure and scope of the tax including the move from a ‘slab’ system to a progressive tax\(^5\); future amendments to support key Scottish Government policies; exemptions and reliefs; and the treatment of both residential and commercial leases.
- Questions 9-13 related to anti-avoidance measures; and proposals for online returns and linking payment of tax with registration.
- Question 14 sought views on the treatment of partnerships and trusts.
- Questions 15 and 16 covered business and regulatory and equalities draft impact assessments.
- Question 17 sought any other views.

19. The consultation document was published to enable a wide range of people and representative bodies with an interest in and experience of tax matters to comment. A total of 56 responses were received from individuals and organisations. Copies of the non-confidential responses can be accessed through the Scottish Government’s Library (0131 244 4565) or website.\(^6\) ODS Consulting was appointed by the Scottish Government to undertake an analysis of the responses received to the consultation and their report has been published on the Scottish Government’s website.\(^7\)

20. The Scottish Government worked with a range of organisations, bodies and groups to develop the proposals contained in the Bill. During the consultation period, public discussion group events were held in Edinburgh, Aberdeen, Perth and Glasgow to provide stakeholders with an interest in this matter to communicate their views. Meetings were also held with representative bodies including the Law Society of Scotland, the Council of Mortgage Lenders, the Chartered Institute of Taxation, the Scottish Tenant Farmers’ forum, and the Institute of Chartered Accountants of Scotland.

Summary of responses

21. Issues raised during the consultation that are relevant to specific measures in the Bill are discussed under the relevant section headings below, including the alternative approaches that were considered. The consultation generated a wide range of views. However, not all were directly relevant to the Bill and so not all of them are referenced here. A summary of responses to the consultation is set out below:

- The overwhelming majority (74%) of respondents supported the move to a progressive tax for residential property.

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\(^4\) Link to consultation paper [http://www.scotland.gov.uk/Publications/2012/06/1301](http://www.scotland.gov.uk/Publications/2012/06/1301)

\(^5\) See paragraphs 34 and 35 below for an explanation of these terms.

\(^6\) Link to non-confidential consultation responses: [http://www.scotland.gov.uk/Publications/2012/10/1031/0](http://www.scotland.gov.uk/Publications/2012/10/1031/0)

\(^7\) Link to analysis report on consultation responses: [http://www.scotland.gov.uk/Publications/2012/10/8469](http://www.scotland.gov.uk/Publications/2012/10/8469)
• There was majority support for amending LBTT in future to align with government priorities.
• On the topic of exemptions and reliefs, there was support for maintaining the current rules. There was also support, however, for extending reliefs to support compulsory purchase of empty homes to bring them back into use. There were many more suggestions of new reliefs or exemptions. And there was widespread support for making the rules simpler and easier to understand.
• The majority supported exemptions for residential leases of 20 years or less.
• The complexities of commercial leases (in comparison with residential leases) were widely acknowledged. Some practical measures were proposed for improving the LBTT arrangements for commercial leases in future, but there was recognition that more time would be needed to assess and consult on these.
• On the topic of anti-avoidance (or anti-abuse) measures, the strength of overall argument seemed to favour a general anti-avoidance rule (GAAR).
• As far as administration of LBTT is concerned, there was majority support for a new online facility linking LBTT returns with LBTT payment and registration of title. But there was also a clear view that online returns should not be compulsory.
• There was general support for aligning LBTT with Scots law in relation to partnerships and trusts. However, this was seen as another area of complexity requiring further detailed work and consultation.
• Several practical implementation issues were raised. These included the need for clear guidance and ongoing advice; resourcing of Revenue Scotland and/or Registers of Scotland to establish a robust system; and the need for well-designed transitional arrangements from the current system to LBTT.

22. The consultation process was valuable, and respondents helped significantly to shape the content of the Bill. The Scottish Government is grateful to all who contributed their time, input and assistance to the process.

SECTION 1: ADMINISTRATION OF THE TAX

Overview

23. LBTT will be administered by Revenue Scotland. While Revenue Scotland will exist at first as a part of the Scottish Government, by 2015, in line with international best practice, it will be given a separate formal statutory basis. This will establish the body’s operational independence from the Scottish Ministers and will set its governance, accountability arrangements and structure.

24. It is proposed that Revenue Scotland will work with RoS on the administration of LBTT and with the Scottish Environment Protection Agency (“SEPA”), Scotland’s environmental regulator, on the administration of the replacement for Landfill Tax. This approach offers advantages in terms of flexibility and greater scope for efficiencies and, therefore, for keeping costs down.
25. The registration of title to land is the longstanding, core business of RoS. It already registers most of the transactions on which LBTT would be payable. RoS is committed to developing its e-registration products to enable the majority of transactions to be submitted electronically. It will also develop an electronic system to receive payments and administer tax returns for LBTT. This should enable RoS to use the synergies available from combining payment and registration into one system, eliminating duplication and unnecessary effort to create a simpler, end-to-end approach to processing land transactions to the advantage of both taxpayers and tax authorities.

26. Working together with RoS and Revenue Scotland, the Scottish Government will ensure that LBTT is delivered on time and that there will be a smooth transition to the replacement tax alongside the withdrawal of SDLT. Improvements to processes will be made by means of this Bill, others through the Tax Management Bill and through the design of the administration and IT arrangements for collection of the tax.

**Alternative approaches**

27. Several options were considered as to how LBTT could be administered. The three principal options were: contracting the task to HMRC; administration by the new tax authority, or using an existing Scottish body. The Scottish Government examined the option of contracting the work to HMRC carefully and concluded (as confirmed to the Scottish Parliament Finance Committee\(^8\)) that using HMRC would be a more expensive option than using existing Scottish agencies to collect the two devolved taxes on behalf of Revenue Scotland. The Scottish Government also noted that delegating administration to HMRC would restrict the Scottish Government’s ability to introduce a tax that was in any material respect different from SDLT.

**Tax returns and payment arrangements**

*Returns*

28. The Cabinet Secretary for Finance, Employment and Sustainable Growth said in his statement to the Parliament on 7 June 2012: “it is important to create certainty around the amount of tax that individuals have to pay”. Accordingly, this Bill makes provision for a tax which should be as simple as possible to understand and pay and which will place the minimum administrative burden on the taxpayer or their agent and on the tax authority.

29. The Scottish Government intends that, as far as possible, all tax returns for LBTT should be submitted and tax paid electronically. Submitting returns and payments online will allow the taxpayer (or in many cases, their agent) to simultaneously register title to property or land as well as allowing the collection process to operate more efficiently by minimising errors or omissions in LBTT returns (for example, the online system could be designed so as to require all relevant fields to be completed). An increasing proportion of tax has been collected electronically in the UK in recent years. This does not, therefore, represent a significant change from the existing arrangements.

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30. At present, there are issues with some elements of SDLT collection because it is based largely on the English property law system, and this does not always fit comfortably with Scots law and practices. An example of differences in property law is that registration of title plays a more important role in Scotland than in England and Wales. Revenue Scotland will help ensure that clear advice and guidance, tailored to Scots law and practices, is available to help taxpayers, agents to understand the new system.

Payment

31. The Scottish Government proposes that taxpayers should continue to have up to 30 calendar days after the effective date (normally when the sale or lease is concluded) both to submit an LBTT return and to pay any tax due. The Bill provides that tax is treated as paid if “arrangements satisfactory to the tax authority” are made for payment of the tax. This wording is drawn from the wording in the Land Registration etc. (Scotland) Act 2012 in relation to the payment of registration fees and is intended to allow forms of payment such as solicitors’ direct debit instructions to be treated as if they are cleared funds.

32. To ensure prompt payment and deliver administrative efficiencies, the Bill requires agents to submit a complete LBTT return and pay any tax due before any application to RoS in respect of the Land Register or Books of Council and Session can be accepted. The Scottish Government understands that for residential transactions, solicitors receive funds from their clients before settlement to cover any SDLT due.

33. However, the Scottish Government is aware of some stakeholders concern in relation to this proposal, based on the fact that in Scotland a buyer or tenant cannot obtain a ‘real right’ over land or buildings until registration has taken place. Some stakeholders were concerned that this could create an unnecessary risk for buyers and that it might have unintended, knock-on effects on third parties, such as lenders. Following further discussions with the Law Society of Scotland, the Scottish Government believes that the “arrangements satisfactory to the Tax Authority” wording mentioned above – coupled with the introduction of “advance notices” under the Land Registration etc. (Scotland) Act 2012 – will address these concerns.

SECTION 2: STRUCTURE OF THE TAX

Policy objectives

34. Currently SDLT has a “slab” structure, which means that tax is charged at the applicable rate on the whole amount of the transaction. For example, if a house is sold for £260,000 the SDLT due is 3% of the whole amount, £7,800, while for a house costing £240,000, the SDLT due is 1% or £2,400. (Existing tax rates and bands for SDLT are noted in paragraph 42 below).

35. The Scottish Government plans to replace this with a proportional progressive structure, which includes a nil rate band and at least two other bands. This structure will mean that only the proportion of the price above the threshold will be liable to the higher rate of tax. The Scottish Government believes this progressive structure will be more proportionate to the ability to pay and will remove the distortion in prices at the thresholds. Annexes B and C of the LBTT
consultation paper, published in June 2012, set out three illustrative examples of how LBTT might operate in Scotland, based on a progressive structure and including indicative rates. As the consultation paper explains, these examples are provided for illustrative purposes only, to demonstrate the principle of a progressive tax. They may not reflect the Scottish Government’s final position on the rates and bands of LBTT when these are set.

36. The Bill also provides that the progressive structure of LBTT will apply to both residential and non-residential transactions.

37. The tax will come into effect on 1 April 2015. The Scottish Government will set the rates and bands for the tax by subordinate legislation nearer the time that the tax will take effect, and after the Bill is expected to have completed its Parliamentary stages. This is because it would be premature to set rates now for a tax that would not come into effect for over two years, particularly when the economic outlook is uncertain. Governments do not usually set rates this far in advance, as it prevents them from taking a range of different, time-sensitive factors into account. The UK Government for example, has not yet set the rates and bands for SDLT for 2015-16. It is the common practice for governments to set tax rates and bands as part of the annual budget process.

**Consultation**

38. The overwhelming majority of respondents (74%) who answered the specific question about the structure of the tax supported the principle of moving to a progressive structure. The main reasons given were that this was fairer and removed anomalies on either side of current threshold levels. The Council of Mortgage Lenders’ longstanding view of the slab tax is as follows:

“The slab system of stamp duty causes inefficiencies. Buyers pay stamp duty on the full price of the property when each threshold is reached. This distorts house prices because of the jump in stamp duty at each threshold creating the bunching of prices and sales around the threshold. This can also lead to losses through tax avoidance measures such as sellers artificially boosting the value of fixtures and fittings in their properties.”

39. In its response to the consultation, the Building Societies Association said that:

“[The current system] results in cautious consumers reluctant to buy a property in the next price band due to the prohibitive increase in stamp duty. It also puts downward pressure on prices of properties with market values just above threshold levels, discouraging these sellers at a time when the number of property transactions is low. A progressive taxation system would avoid these issues and create a more equitable model for tax on acquiring property.”

40. Homes for Scotland provided a further perspective, as follows:

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It is currently very challenging for home builders to sell homes in the £125k to £135k and £250k to £270k price ranges because buyers feel they are paying too much for very little advantage which results in a skewed pricing and product structure on new housing developments... As prices edge above £250k, home builders now design that specific product size out of their range altogether as the market will not pay... A move to a progressive rate system should resolve this.”

41. Based on these and other consultation responses, the Scottish Government is content that a more progressive tax structure for both residential and commercial transactions has the support of a majority of stakeholders, will provide for a tax that is proportionate to the ability to pay and represents a more equitable model for a land transaction tax.

Alternative approaches

42. The main alternative considered was to continue with the existing ‘slab’ structure of SDLT. The current rates and bands for SDLT are as follows:

### Table 1 - Current SDLT rates for residential property

<table>
<thead>
<tr>
<th>Purchase price</th>
<th>SDLT rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to £125,000</td>
<td>Zero</td>
</tr>
<tr>
<td>Over £125,000 to £250,000</td>
<td>1%</td>
</tr>
<tr>
<td>Over £250,000 to £500,000</td>
<td>3%</td>
</tr>
<tr>
<td>Over £500,000 to £1,000,000</td>
<td>4%</td>
</tr>
<tr>
<td>Over £1,000,000 to £2,000,000</td>
<td>5%</td>
</tr>
<tr>
<td>Over £2,000,000</td>
<td>7%</td>
</tr>
<tr>
<td>Over £2,000,000 (purchase by company or partnership with corporate partner or collective investment scheme)</td>
<td>15%</td>
</tr>
</tbody>
</table>

### Table 2 - Current SDLT rates for non-residential or mixed use properties

<table>
<thead>
<tr>
<th>Purchase price</th>
<th>SDLT rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to £150,000 – (for leases) annual rent is under £1,000</td>
<td>Zero</td>
</tr>
<tr>
<td>Up to £150,000 – (for leases) annual rent is £1,000 or more</td>
<td>1%</td>
</tr>
<tr>
<td>Over £150,000 to £250,000</td>
<td>1%</td>
</tr>
<tr>
<td>Over £250,000 to £500,000</td>
<td>3%</td>
</tr>
<tr>
<td>Over £500,000</td>
<td>4%</td>
</tr>
</tbody>
</table>

43. Under SDLT, if a residential property is sold for £260,000, the tax payable is 3% on the entire amount of £260,000 – in this case, £7,800. The tax payable on a house bought for £240,000 is 1% of £240,000 or £2,400. So the tax charge under SDLT is more than 300% higher for the £260,000 property, even though the purchase price is only 8.3% higher.
44. As respondents to the consultation pointed out, this ‘slab’ structure distorts the market by making it unattractive to buy a property at a price that is immediately above a threshold, since the extra tax charged on the whole sum is significantly higher than the tax payable on a slightly lower purchase price. These effects are illustrated in Graph 1 below, which shows the distribution of house sales by value in Scotland. As the Council of Mortgage Lenders pointed out, the current SDLT arrangements also encourage some taxpayers to try to evade tax at the higher rate when the value of a property is just above a threshold, for example, by trying to attach a higher value than the actual market value to moveable items such as carpets or curtains as these items are not liable to SDLT.

45. During the consultation period, a number of organisations who generally supported the proposal to introduce progressive rates for residential transactions expressed concerns in relation to commercial properties. These were mainly private development companies and firms providing professional services to such companies. The concern focused on the potential for a disproportionate effect on the high value commercial property transactions liable to the top rate of LBTT and the need to maintain Scotland’s position as an attractive place in which to invest. The Scottish Government concluded that it could be confusing to have a system of progressive tax rates for residential properties and a ‘slab’ structure of tax rates for commercial properties. Tax rates and bands will be set taking into account these views and other relevant factors. Overall, a system of progressive tax rates was considered to be the preferred option.

Graph 1 – number of homes sold in Scotland by sale price (2007) – data from Registers of Scotland

46. Graph 1 shows the impact that SDLT currently has on the housing market as it indicates that there are peaks in numbers of sales just below SDLT price thresholds, with very few sales
just above those thresholds. These effects are most obvious in the residential property market, but they also apply to the commercial and industrial property markets.

47. For many years the ‘slab structure’ of SDLT has been the subject of criticism. The Council of Mortgage Lenders concluded in a 2003 research report\(^\text{10}\) that the slab structure “is clearly an encouragement to bunching of sales around the thresholds and avoidance measures, such as artificially boosting the value of fixtures and fittings”. The effect of the slab structure is that it distorts relative house prices “which implies that the markets do not operate efficiently”\(^\text{11}\) in accordance with the principles of optimal taxation.

48. The inclusion of Value Added Tax (“VAT”) in the chargeable consideration for a transaction, where the seller has waived their exemption to VAT, has also been the subject of criticism. The Scottish Government notes the Court of Session’s judgment, in the case of Glenrothes Development Corporation v Inland Revenue Commissioners (1994 S.C. 169), in particular Lord Hope’s comments that, “The amount of the stamp duty is charged by reference to the amount or value of the consideration for sale, not by reference to the value of the property.” The Scottish Government’s position, in relation to LBTT, which is a transaction tax and not a tax on the value of land, is that it agrees with Lord Hope that LBTT should be charged on the “amount or value” of the transaction and that, “uniformity of charge between comparable subjects of equivalent value is not required, as each transaction must be examined and [LBTT] assessed on it according to its own terms”. This means that, like SDLT, LBTT will be charged on the total purchase price, including any VAT.

49. However, where the amount of tax charged is based on market value, the market value of an asset does not include VAT even if VAT were chargeable on the transfer of the asset. This is because market value is based on a hypothetical transaction, not on the actual transaction.

SECTION 3: TAX AVOIDANCE

Policy objectives

50. The Scottish Government believes that all transactions involving land or buildings in Scotland should be liable for LBTT, except in certain limited and specific circumstances set out in legislation. Payment of tax demonstrates social responsibility as the revenues raised through prompt payment and the efficient collection of the tax contribute to the Scottish Government’s purpose. The Scottish Government is determined to protect the interests of the public, including the vast majority of taxpayers who are compliant. For these reasons, the Scottish Government has considered the issue of tax avoidance (and related matters) carefully both in the context of this Bill and in the wider context of a devolved tax system, of which LBTT will be a part.

51. The Scottish Government has set out its position on avoidance of devolved tax in this section of the memorandum to make clear its policy intent in relation to this Bill. However, the Scottish Government is also aware that avoidance is an issue that is relevant to all devolved


\(^{11}\) Ibid, page 15.
This document relates to the Land and Buildings Transaction Tax (Scotland) Bill (SP Bill 19) as introduced in the Scottish Parliament on 29 November 2012

taxes. The position of the Scottish Government on tax avoidance will be further explained in the forthcoming consultation on a Tax Management Bill.

The nature of tax avoidance activity

52. The Scottish Government broadly endorses the definition of tax avoidance: “The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his [or her] tax liability.”\(^{12}\) Tax avoidance is, therefore, likely to involve taxpayers minimising their tax liability through measures that were not envisaged when the relevant legislation was passed, thus achieving a result that was not intended by Parliament. Tax avoidance is not an illegal activity but it does place revenues at risk, for example if other taxpayers begin to take comparable action, leading to a fall in revenues. Tax avoidance may be felt to be unfair by compliant taxpayers who continue to meet the full extent of their liabilities as intended by the law.

53. It follows that tax avoidance takes place when someone (including a company or partnership) seeks to reduce, delay, or avoid altogether their liability for tax by taking action which may be legal but which can reasonably be regarded as a contrivance not in keeping with the spirit or intention of the law. Tax avoidance arrangements are often highly artificial and often exploit areas of the tax system, such as tax thresholds, reliefs, allowances or exemptions, to reduce or avoid tax liability in circumstances where the purpose originally intended by Parliament in granting the reliefs, etc. is not fulfilled by the taxpayer.

The difference between tax evasion and tax avoidance

54. Unlike tax avoidance, tax evasion is an illegal activity. Tax evasion involves or leads to a taxpayer fraudulently not paying or underpaying tax, for example, by under-declaring the value of chargeable consideration.

Why tax avoidance is a cause for concern

55. The Scottish Government believes that tax avoidance distorts the balance of the tax system making it less economically efficient, and undermines the intent for progressive taxation. It can also undermine confidence in the tax system among compliant taxpayers, and lead to perceptions of unfairness. It reduces the tax base, meaning that compliant taxpayers have to pay higher taxes to receive the same level of public services or receive a lower level of public services than would otherwise be the case.

56. From a policy perspective, tax avoidance makes it difficult to forecast tax revenues as avoidance behaviour adds to the “tax gap” (the difference between expected tax revenues and the amount of tax actually collected). It can also result in the tax authority adding more and more detailed provisions to the tax system, in order to close down particular forms of avoidance and limit the scope for new schemes. Over time, this complicates the tax system and makes it difficult to interpret and understand. For all these reasons, the Scottish Government believes there is a strong public interest in taking effective action to minimise tax avoidance.

The Scottish Government’s approach to avoidance of LBTT

57. As noted in paragraph 50 above, payment of tax demonstrates social responsibility and the Scottish Government is keen to promote a culture of responsible tax paying to protect the interests of compliant taxpayers and users of public services. SDLT has been subject to a range of tax avoidance schemes over recent years, meaning that there is a clear, existing risk to LBTT revenues that must be addressed. The UK Chancellor of the Exchequer announced a number of anti-avoidance measures for SDLT in the UK’s 2012 Budget, which the Scottish Government has taken into account in considering its overall approach to avoidance (see also paragraph 14 above).

58. Sections 4 and 5 below deal with the policy intent behind the Scottish Government’s scheme of exemptions and reliefs from LBTT. In explaining the circumstances in which a transaction may qualify for either an exemption or relief from LBTT, the Scottish Government has made clear the purpose for which the exemption or relief is being granted. Subject to the Scottish Parliament’s approval of the Bill, transactions that are outside the intended scope of any of the exemptions or reliefs should, in the view of the Scottish Government, be liable to pay the appropriate full amount of LBTT.

59. The Scottish Government also intends to make use of two different types of anti-avoidance rule. These are targeted anti-avoidance rules (“TAAR’s”) and, subject to consultation, a general anti-avoidance rule (“GAAR”).

60. TAARs in this context apply to specific exemptions or reliefs, or groups of exemptions and reliefs, from LBTT. They will establish the boundaries for reliefs. If a transaction goes beyond these boundaries, it should not be considered to fall within the purpose for which those exemptions and reliefs were provided. The TAARS will aim to make clear that avoidance schemes which seek to artificially design transactions in order to claim a relief or exemption will not be valid and that such schemes are likely to be liable to the appropriate amount of tax in full. There are a number of TAARs included in the LBTT Bill (for example, schedule 10, paragraph 8(b) in relation to group relief and schedule 11, paragraph 7(e)(ii) in relation to acquisition relief).

61. A GAAR, subject to consultation, will set out a basis on which tax avoidance arrangements can be counteracted. Provisions for a GAAR are not included in this Bill and are not, therefore, discussed in any further detail in this memorandum. This issue will be included in the consultation on Tax Management, to be brought forward shortly, as it will apply to devolved taxes in general rather than just to LBTT.

62. The Scottish Government has concluded that the most effective approach to reducing the risk of avoidance lies not in one single measure but rather in a combination of the following:

- Clear policy and legislation - for example, much of the tax avoidance activity for SDLT relates to reliefs. The Scottish Government has carefully considered the reasons why each relief is provided and has continued reliefs only where there is good evidence in support of them;
• Good tax design - for example, the change to proportional, progressive tax rates will reduce the incentive to declare transaction prices that are lower than they might otherwise be, so that a transaction is taxed at a lower tax band; and
• Inclusion of anti-avoidance measures through a number of targeted anti-avoidance rules (TAARs).

63. All of the above will be further supported by active, timely and effective follow-up action by Revenue Scotland through an enquiry system which will be carried out on both a risk assessment and random basis.

Consultation

64. The Scottish Government’s consultation document on LBTT made two proposals in relation to avoidance – to include anti-avoidance provisions and to provide disincentives to buyers purchasing homes that are ‘wrapped’ in corporate entities.

65. Stakeholder response to these proposals was mixed. A higher number of respondents agreed with these proposals than disagreed but the majority of their comments were of a general nature. Most respondents, however, acknowledged that tax avoidance measures are needed. Where responses were more detailed (mostly amongst legal and accountancy bodies and practitioners), a number of common themes emerged, as follows:

• A well-drafted GAAR was preferable to adding to the already complex layers of TAARs associated with SDLT;
• If TAARs were considered in Scotland for LBTT purposes, these should not simply transcribe existing SDLT measures; and
• The current 15% tax under SDLT on high value corporate purchases of residential property was punitive, largely unnecessary and might have an unintended, negative impact on some agricultural transactions.

66. Stakeholders responding to the consultation said that the existing TAAR set out in sections 75A-C of the Finance Act 2003 is complex and is regarded by tax practitioners as ineffective. Taking consultation responses from a number of stakeholders into account, the Scottish Government believes that the existing SDLT anti-avoidance rule in sections 75A-C of the Finance Act 2003 should not be replicated, on the basis that a GAAR will be proposed in the Tax Management Bill.

Alternative approaches

67. Responses to the consultation show that most stakeholders agree that anti-avoidance measures are needed. Avoidance penalises the majority of compliant taxpayers. The Scottish Government is keen to avoid having to add layers of further legislation to address avoidance activity. The measures described above, including the combination of selected TAARs and a GAAR, are considered to provide an effective set of anti-avoidance measures.
SECTION 4: ‘NOTIFIABLE’ AND EXEMPT TRANSACTIONS

Policy objectives

68. Most land and property transactions in Scotland will have to be notified to the tax collection agent (RoS) on a LBTT return within a certain time limit, even if in some cases no tax is due. This is already the case in relation to SDLT. A land transaction will be ‘notifiable’ unless it is an exempt transaction (described below), the acquisition of a minor interest (that is to say an interest other than ownership) where the chargeable consideration is within the nil rate tax band, a standard transaction where the chargeable consideration in under £40,000 or, subject to regulations, certain land acquisitions relating to leases.

69. All land and buildings transactions will be chargeable to LBTT unless they are specifically exempted by legislation. As the Scottish Government signalled in its Taking Forward a Land and Buildings Transaction Tax consultation paper, it considers that some of the exemptions currently available under the SDLT regime are also relevant to a LBTT regime and should continue. These types of transactions include:

- transfers of property on divorce, separation or the end of a civil partnership;
- property transactions where no money or other contribution that has a monetary value changes hands (e.g. a gift);
- grants of certain leases (social tenancies) by Registered Social Landlords;
- land or property which is transferred under succession law when the previous owner dies; and
- acquisitions by the Crown.

70. The types of transactions listed above are not chargeable and do not require to be notified to the Tax Authority because they are exempt. (In the case of leases granted by Registered Social Landlords, these will fall under the more general exemption for all residential leases – see Section 6 below). There are other exemptions available under SDLT which have not been included in the LBTT as they relate to property transactions specific to English law.

71. To ensure future flexibility within the LBTT system, the Scottish Government also proposes that it should be able, through secondary legislation, to add or remove types of transactions from the list of exempt transactions.

Consultation

72. A significant majority (74%) of those who responded to the specific consultation question on exemptions agreed with the proposal to exempt the types of transactions suggested and to dispense with the need to submit an LBTT return for such transactions.

“We agree with the broad strategy that pre-existing exemptions from SDLT should be replicated under the LBTT regime and that compliance burdens should be minimised by dispensing with the requirement to submit LBTT returns wherever this can be done.” (Institute of Chartered Accountants of Scotland)
73. Amongst those who broadly disagreed with the specific consultation question there was little common ground. The points raised often related more to the provision of reliefs than exemptions, which highlights the confusion experienced by some stakeholders in determining when a transaction is an exempt transaction or is a transaction which attracts relief from the tax charge.

**Alternative approaches**

74. The alternative approaches, in relation to exemptions, would be either to add types of transactions to or remove types of transactions from the list of exempt transactions.

75. A common thread running through the LBTT consultation responses was a plea by stakeholders for the Scottish Government to simplify the replacement tax. There was, however, no support for the removal of any of the types of transactions currently exempt from an SDLT charge. The comment was made at one of the public consultation events that the removal of the current exemptions might risk unpredictable and unintended consequences.

76. Some stakeholders suggested types of transactions which could be added to the list of exempt transactions and the Scottish Government has carefully considered these suggestions. However, the Scottish Government has concluded that it would not be prudent to make any additions to the list of exempt transactions for LBTT, given the need to maintain revenues and the lack of strong evidence to support further exemptions.

77. A period of time will be required to enable the LBTT system to become embedded and to allow for sufficient financial and statistical data to be collected to enable informed policy decisions to be taken in the future. The position on exemptions will be kept under review as part of the ongoing process of devolved tax planning and management. The subordinate legislation powers included in the Bill would allow Scottish Ministers to add or delete types of transactions from the list of exempt transactions and this will ensure that the LBTT system will be sufficiently flexible to accommodate future changes.

**SECTION 5: TRANSACTIONS FOR WHICH TAX RELIEF IS AVAILABLE**

**Policy objectives**

78. As highlighted in the Scottish Government’s consultation paper *Taking forward a Land and Buildings Transaction Tax*[^13] there are currently over 30 separate reliefs available under the SDLT system. This adds layers of complexity to the tax. As stated above, the Scottish Government is keen to simplify the tax where possible and, after listening to the views of a range of stakeholders, has carefully considered which reliefs would be appropriate for LBTT.

79. The Scottish Government recognises that the housing and commercial property markets change over time and, where practical and affordable, wishes to do what it can, within the powers available to it, to help create sound, sustainable market conditions. Taking all of these factors into account, the Scottish Government believes there should be some reliefs provided in

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an LBTT system. These should not be confused with transactions which are classed as “exempt transactions” in schedule 1 of the Bill, such as gifts of property (exempt transactions are considered in Section 4 above).

Current SDLT reliefs/provisions that will be provided under a LBTT system

- **Sale and leaseback arrangements** – The purpose of this relief is to provide relief from LBTT only in the circumstances where land or buildings have been sold and then “leased back” by the seller to the buyer. This relief ensures there is not a double charge of LBTT. This is achieved by making the leaseback element of the arrangement “exempt from charge”.

- **Certain acquisitions of residential property** – Acquisition by a developer or property trader relief will apply where residential property is bought by the developer or property trader in part exchange for a new residential property. The provision of this relief will help a developer/property trader to sell new homes without LBTT being payable twice. A further relief will be available to property developers who acquire a residential property from an individual where a chain of transactions breaks down.

- **Transfers involving multiple dwellings** – This relief ensures that where a taxpayer is buying multiple dwellings in a single transaction, the taxpayer is not taxed at a high tax band when the transaction involves dwellings that, individually, may each involve consideration only falling within low bands. The Scottish Government wishes to encourage institutional and other large scale investment in the private rented sector in order to help improve standards and the quality of housing in the sector, and this relief will help to achieve that.

- **Certain acquisitions by Registered Social Landlords (RSL)** – This relief is available subject to certain conditions, set out in the legislation, being met. In recognition of the important role played by RSLs in the housing market the Scottish Government considers it is important to provide this relief.

- **Alternative Property Finance** – Alternative Finance Products may be used by any consumer when buying a residential property and are economically equivalent to conventional banking products. A series of land transactions takes place under these arrangements (each of which gives rise to an LBTT charge). The effect of the relief is to ensure that LBTT is paid only once and brings the LBTT payable on the purchase of a property using an alternative finance product into line with the tax that would be due where a purchase is made using a conventional mortgage product. The Scottish Government considers that this is fair and equitable.

- **Alternative Finance Investment Bonds (AFIB)** – With a conventional bond, the investor does not have a direct ownership share in the underlying asset but holds an interest-bearing certificate. As LBTT is a charge on the acquisition of a chargeable interest in land or property situated in Scotland, issuing a conventional bond secured on a building will not cause any LBTT to arise. In an AFIB, however, the investor owns part of the underlying asset and interests in land and property in Scotland may be used as that asset. The necessary changes in ownership of the underlying assets involved in an AFIB structure may give rise to a number of LBTT charges (along with capital gains tax and capital allowance issues which are not matters the Scottish Parliament can legislate on). In relation to LBTT, the Scottish Government wishes to provide a similar outcome for
AFIBs to their equivalent conventional finance products. This can be achieved by relieving the LBTT charges. Detailed provisions relating to AFIBs do not currently appear in the LBTT Bill but the Scottish Government intends, following further detailed technical consideration, to bring forward an amendment to the Bill at Stage 2 to deal with this issue.

- **Crofting community right to buy** – Arose as a result of the Land Reform (Scotland) Act 2003 creating a regime in which a crofting community body, representing an identified crofting community, may acquire eligible croft land associated with that crofting community and sporting rights. The crofting community body may also acquire, at the same time, or within a specified period after it has purchased the eligible croft land, the interest of the tenant in tenanted land.

- **Group relief** – Will be available to companies wherever incorporated and in principle no matter how large and complicated the group structure may be. The Scottish Government considers it is appropriate to retain this relief within LBTT as there is no overall change in economic interest or benefit when land or property is transferred amongst companies within a group structure. However, to benefit from the relief the group must be structured for genuine *bona fide* economic/commercial reasons and not primarily for the purpose of mitigation of tax. Group relief may be withdrawn. Collectively these anti-avoidance provisions within the Bill mean that the intentions and motives of the parties to the transaction, which can be inferred or construed from any evidence, are just as important in determining the availability of this relief as the forms of the group structure and the arrangements in respect of any transaction.

- **Reconstruction and acquisition relief** – Reconstruction relief will provide relief from LBTT where a company acquires the whole or part of an undertaking in another company under a scheme of reconstruction. Where the undertaking transferred includes an interest in land and the conditions as set out in the LBTT legislation are met then relief from LBTT is provided. Acquisition relief will reduce the rate of tax to a level which will be set by regulation where a land transaction is entered into as part of an acquisition of an undertaking of a company in exchange for shares, or shares and cash up to 10% of the nominal value of the shares.

- **Incorporation of limited liability partnerships** – Subject to certain specified conditions being met, relief from LBTT may be claimed on a land transaction which transfers a chargeable interest from a person (the transferor) to a limited liability partnership in connection with its incorporation. One of the conditions is that the transferor is a partner in a partnership comprised of all the persons who are (or are to be) members of the limited liability partnership. The Scottish Government considers that provision of this relief gives smaller businesses a certain degree of flexibility around their legal constitution.

- **Charities and charitable trusts** – Relief from LBTT will be available where a charity, or a charitable trust, purchases an interest in land, subject to certain conditions which are set out in the Bill. To qualify for this relief any charity will require to be registered with the Office of the Scottish Charity Regulator (OSCR). Under the Charities and Trustee Investment (Scotland) Act 2005, bodies which represent themselves as charities in Scotland are required to register with OSCR. This requirement includes bodies which are established and/or registered as charities in other legal jurisdictions, such as England and Wales. Bodies established outside Scotland which gain charitable status here (and their
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charity trustees) incur the same obligations and duties as other charities on the Scottish Charity Register. A large number of charities registered outside Scotland may only have relatively minor operations in Scotland, such as sending a newsletter or information to Scottish members, awarding a grant to a body in Scotland or merely advertising in a newspaper which may also be seen in Scotland. These bodies may operate in Scotland using the term ‘charity’ without having to register with OSCR. However, if the charity in question occupies any land or premises in Scotland or carries out activities in any office, shop or premises in Scotland then its operations are no longer considered minor and it must register with OSCR (there is no registration fee) and it will be subject to regulation by OSCR.

As at September 2012 according to OSCR’s website there were 23,553 charities listed on the Scottish Charity Register. As at September 2012, OSCR has received 611 new applications in 2012-13 (including 188 new applications to become a Scottish Charitable Incorporated Organisation (SCIO)). The requirement to register with OSCR is the same requirement that is already placed on charitable and other organisations that wish to claim a reduction or remission of non-domestic rates payable under the Local Government (Financial Provisions etc.) (Scotland) Act 1962. The Scottish Government considers this requirement will help to ensure that only genuine charitable organisations and trusts will receive the relief.

- Compulsory purchase facilitating development – As signalled in the LBTT consultation paper, the Scottish Government intends to provide an amended Compulsory Purchase Order (CPO) relief. Under the current SDLT regime, a local authority does not pay SDLT if it purchases land or property through a CPO with the intention of transferring it directly to a third party to facilitate development. CPO relief within an LBTT system is designed so that it will be available in respect of all situations where the local authority transfers land to a third party without being limited to situations where this will facilitate “development”. This will enable local authorities to use CPOs to purchase long-term empty homes, where the home will not be structurally altered after it is resold (and so would not attract relief under the current SDLT definition of “development”) without having to pay LBTT.

- Compliance with planning obligations – A planning authority may, when granting planning permission for a development, require a developer to provide affordable housing. This is frequently done through a condition attached to the planning consent. Usually the developer transfers the housing to the local authority to run once it is finished. But there may be two successive charges to LBTT if the developer buys the land from its original owner and then transfers the completed building to the local authority. Although the local authority would be liable for any LBTT on the latter transaction, it will usually seek re-imbursement from the developer, as part of the arrangements for the granting of planning permission. The Scottish Government intends that subject to certain conditions (set out in legislation) a local authority can claim 100% relief from this LBTT liability, so relieving the developer from a double charge.

- Transfers involving public bodies – In light of the Scottish Government’s public sector reform policy it intends to retain this relief under LBTT. Relief from LBTT may be claimed on a land transaction which is entered into by or under statute; both the buyer and seller are public bodies; and the land transaction was entered into on, or in

14 Link to OSCR’s website http://www.oscr.org.uk/
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consequence of, or in connection with, a reorganisation of public bodies. Additionally the Scottish Government intends, subject to Parliament’s approval, that LBTT relief may also be claimed in cases where the Scottish Ministers make an order that it should be available and one or other of the parties to the transaction is a public body. The legislation sets out what are classed as public bodies for the purposes of being eligible to claim this relief.

- Diplomatic premises and sovereign bodies and international organisations reliefs will be available under LBTT to ensure the Scottish Government meets its international obligations. Provisions relating to these reliefs do not appear on the face of the Bill as relief is already provided for by existing statutes such as the Diplomatic Privileges Act 1964 (implementing the Vienna Convention on Diplomatic Relations 1961) and the Consular Relations Act 1968 (implementing the Vienna Convention on Consular Relations 1963).

Current SDLT reliefs/provisions that will not be provided for under a LBTT system

80. The Scottish Government set out its intention in the LBTT consultation paper to further simplify the approach to LBTT by not providing a number of reliefs currently available under the SDLT system: right to buy; shared ownership; acquisition by bodies established for national purposes; and collective enfranchisement by leaseholders (leaseholder ownership is not used in Scotland). After further careful consideration, in the light of the consultation responses, the Scottish Government proposes in addition to remove some further reliefs available under SDLT so that they will not be available under the LBTT system.

- Certain acquisitions of residential property – Acquisition by property traders from personal representatives of a deceased individual; and acquisition by employer or property trader in cases of relocation of employment. The Scottish Government is not persuaded that these activities would not occur without these reliefs and therefore does not intend to make these reliefs available under LBTT.

- Demutualisation of an insurance company or a building society – The Scottish Government considers that these reliefs relate to a previous time when there was a significant level of demutualisation activity in the financial sector. It is no longer relevant to make provision for such reliefs under LBTT.

- Reorganisation of UK Parliamentary constituencies – This allows for relief where parliamentary constituencies change and, in consequence of that change, the previous local constituency association transfers a chargeable interest to a new local constituency association. This may be needed, for example, where an old constituency is split into two and two new associations are formed, or where two previous constituencies merge and one is formed. The Scottish Government does not consider it is appropriate to provide such a relief within the LBTT system. Whilst this relief from SDLT relates only to Westminster parliamentary constituencies, the Scottish Government has no plans to introduce a similar LBTT relief for Scottish Parliament constituencies.

- The Scottish Government does not intend to include the current SDLT Sub-sale provisions15 (which are often combined with other reliefs) in the LBTT. These rules apply where Party A contracts to purchase land from Party B who might, for example, be a land value speculator, but Party B sells the land to Party C on the same day as the

15 The UK Government is in the process of reviewing these provisions
completion of the formal contract with Party A. In this case, there will only be one transaction where there is a requirement to pay SDLT. As the sub-sale rules are not considered a relief as such, no claim is submitted through an SDLT return so there are no records of the amount of tax foregone by the tax authority as a result of these rules. There is, however, strong evidence to suggest that the sub-sale rules act as a gateway to a significant amount of avoidance activity.

- **New zero-carbon homes relief** - After further careful consideration, including taking account of comments made by stakeholders through the LBTT consultation paper and at the public consultation events held in July and August 2012, the Scottish Government does not intend to include within LBTT the new zero-carbon homes relief, which was available under the SDLT system for a time-limited five-year period from 1 October 2007. There is little evidence to suggest that this relief achieved its stated objectives of helping to kick-start the market for zero-carbon homes, encourage microgeneration technologies, and raise public awareness of the benefits of living in zero-carbon homes. The Scottish Government does, however, welcome further representations from interested parties on whether alternative arrangements could be devised which would help support Scotland’s climate change targets.

**Consultation**

81. During the consultation on LBTT, many stakeholders strongly suggested that LBTT should be less complex than the current SDLT. During the consultation events, others also commented that some tax reliefs may be potential “gateways” for tax avoidance. Tax avoidance activities place tax revenue at risk and are unfair on compliant taxpayers who meet the full extent of their tax liabilities as intended by the legislation.

82. Just over half of the consultation responses responded to the proposal to extend compulsory purchase order relief to allow local authorities to benefit from the relief where they compulsorily purchase an empty home for onward sale. The overwhelming majority of consultees who responded agreed with the proposal.

“This would undoubtedly make the additional powers due in April 2013 to bring long term empty properties back into use more attractive to local government...”
(COSLA)

83. Fifty per cent of correspondents commented on the proposal not to provide a Right to Buy or Shared Ownership relief under LBTT. The majority of those who responded (68%) agreed with the proposal. Around 77% of respondents answered the question on the proposed list of LBTT reliefs. As outlined in the ODS Analysis of Responses Report16, many added qualifications or suggested additions. There was no clear pattern among the many detailed comments made by respondents whether they agreed with the proposal, disagreed with the proposal or were more neutral. This may in part be due in some part to the breadth of reliefs that are currently available under the SDLT system.

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16 Link to ODS Report: [http://www.scotland.gov.uk/Publications/2012/10/8469](http://www.scotland.gov.uk/Publications/2012/10/8469)
Alternative approaches

84. The alternative approaches available in relation to a scheme of reliefs for LBTT would be to either add new reliefs to the scheme or to remove further reliefs from the scheme. There will always be stakeholders with an interest in adding new reliefs to cover their specific interests and there will be other stakeholders who may argue for the removal of reliefs. The costs of additional reliefs would mean those without reliefs would have to pay more to maintain revenues and fewer reliefs would mean the tax burden generally can be lessened. It is also important to note that the cost of reliefs does not remain static and whilst previous years’ costs may provide some indication of potential future costs, the actual cost of reliefs will depend on the number and value of the transactions carried out in any particular year.

85. As mentioned at paragraph 77 above in relation to exempt transactions, a period of time will be required to enable the LBTT system to become embedded and to allow for sufficient financial and statistical data to be collected to enable informed policy decisions to be taken in the future. The position on reliefs will be kept under review as part of the ongoing process of devolved tax planning and management. Subject to the Parliament’s agreement to the Scottish Ministers being granted powers to add or delete reliefs from the LBTT system, the LBTT system will have sufficient flexibility to accommodate future changes.

SECTION 6: COMMERCIAL, AGRICULTURAL AND RESIDENTIAL LEASES

Policy objectives

86. The Scottish Government intends that LBTT should be levied on anyone leasing land or buildings. However, the tax would only cover non-residential transactions. The Bill treats these two types of lease transactions differently.

Residential leases

87. The Scottish Government believes that there is scope to simplify the treatment of residential leases under LBTT. In view of the fact that only leases that are over 20 years long can be registered in the Land Register in Scotland and that the Long Leases (Scotland) Act 2012 will convert ultra-long leases (defined, for the purposes of the Act, as leases that have been granted for more than 175 years and have more than 100 years to run) to ownership, the Scottish Government originally proposed only to require tenants of the few remaining registerable residential leases to submit an LBTT return when the terms of the lease are changed or the lease is renewed. However, the Bill reflects the broader and simpler policy that all residential leases of whatever duration should be exempt from LBTT. “Qualifying leases” under the Long Leases (Scotland) Act 2012 (i.e. ultra long leases that qualify for conversion to ownership on a day to be appointed by Ministers) are, however, excluded from the LBTT exemption for residential leases. These ultra long leases are akin to ownership and, without this exception to the LBTT exemption, there might be an incentive for tenants to opt out of conversion to ownership to avoid LBTT on future transactions. As there are around 9,000 such ultra long leases in Scotland, the potential loss of tax receipts could be significant. Leases that are opted out of conversion to ownership will, therefore, be subject to LBTT on assignation, variation or renunciation as they currently are under SDLT.
Non-residential leases

88. The taxation of non-residential leases (i.e. leases of commercial and agricultural property) is a complex and technical area primarily because the leases themselves are by nature varied and complex. The Scottish Government is aware that the current SDLT treatment of non-residential leases gives rise to many issues for taxpayers and legal practitioners in Scotland. Existing SDLT legislation does not in every respect recognise the way that non-residential leases work in Scotland under Scots law. The Scottish Government is keen to ensure that the LBTT legislation is better aligned with Scots law and practices.

89. Over the course of the summer of 2012 during the Bill’s public consultation period, the Law Society of Scotland convened and chaired a stakeholder group to discuss, among other things, the taxation of non-residential leases. The group included representatives from the Institute of Chartered Accountants of Scotland, the Chartered Institute of Taxation, the Tenant Farmers’ Forum and others. The work of the group led to the inclusion in the Law Society’s LBTT consultation response of four options which might be explored as an alternative to the existing SDLT approach. These are set out below in paragraph 96.

90. There is broad consensus among stakeholders that detailed consideration should be given to the complex issues raised by the taxation of non-residential leases to ensure that the replacement system is efficient and effective and does not give rise to unintended consequences. The Scottish Government agrees that the issues need to be addressed in further detail, and that the revenue and administrative implications of each of the options should be examined. The Scottish Government is therefore convening a working group to consider further the tax treatment of commercial and agricultural leases. The working group will examine the potential options for the treatment of non–residential leases with a view to preparing draft legislative provisions.

91. Accordingly at this stage, the Bill does not make detailed provision in relation to non-residential leases but provides for an order-making power. It is intended that further legislation will be brought forward in due course for approval by the Parliament, either in the form of amendments to the Bill at Stage 2, or in the form of statutory instruments for consideration on the basis that the Bill is enacted.

Consultation

92. Responses to question 8 in the Scottish Government’s consultation document (“What proposals would you make to ensure that the calculation of tax payments due on commercial leases is better aligned with Scots law and practices?”), demonstrated that there is significant support amongst professional bodies representing legal and accountancy/tax professionals and private organisations concerned with commercial development for simplification of the current system. In most cases the need to align better with Scots law was also mentioned.

93. A number of problems with the existing system were identified, as follows:

- The difficulties of establishing the basis for payment due to complex or unpredictable rent structures such as those often associated with wind-farm leases;
• Anomalies in relation to other parts of the UK because of the different legal system; and
• The unfairness of an ‘up-front’ tax where businesses will frequently need to move, terminate or assign leases in mid-term.

94. Respondents made specific suggestions for improvement and some, such as The Law Society of Scotland’s response, were very detailed. The Law Society said that:

“...it can be very difficult for solicitors and other tax advisers to calculate SDLT on lease rentals...The administrative burden is severe...”

95. Several other respondents referred to and supported the Law Society’s response. For example, the Scottish Property Federation commented as follows:

“The current regime does not sit well with Scots property law and practices and the tax itself is a considerable ‘up-front’ burden on businesses.”

96. Several respondents suggested a move to taxing rent. The Law Society set out four options for the treatment of non-residential leases under LBTT which they recommended should be considered:

• Tax payable annually as a percentage of actual rent paid;
• Tax paid on Net Present Value (NPV) but payable in instalments at the tenant’s option;
• Tax paid on NPV but recalculated every five years based on actual rent paid; and
• Tax paid as a percentage of average rent payable under the lease.

Alternative approaches

97. The Scottish Government did not consult on the merits of deferring consideration of commercial leases to a later stage in its consultation document, as it made sense to consider the legislation as a complete package. To that extent, therefore, this is an alternative approach to what was set out in the consultation and is being taken as a result of stakeholder feedback.

SECTION 7: COMMERCIAL PROPERTIES, COMPANIES, TRUSTS AND PARTNERSHIPS

Policy objectives

98. The Scottish Government believes that companies, trusts and partnerships should be liable to pay LBTT on transactions in land or buildings. In designing a system which supports the four principles of taxation - certainty, convenience, efficiency and a tax that is proportionate to the ability to pay - the Scottish Government intends to put in place an LBTT regime which will not create unnecessary administrative burdens on businesses entering into transactions in land or buildings in Scotland.
The following general points relate to the Scottish Government’s policy intentions for companies, trusts and partnerships overall, rather than the specific, individual treatment, under LBTT, of any one of these groups:

- The aim in relation to the taxation of commercial transactions under LBTT is to encourage inward investment and maintain Scotland’s reputation as the most attractive part of the UK in which to do business;

- Where the policy intent is to retain the existing rules under SDLT, it is important to bear in mind that LBTT will have a proportional progressive structure (as opposed to a ‘slab’ structure) for commercial transactions. This will lead to some variations between the amount of LBTT and SDLT due on a transaction of equivalent value. The Scottish Government notes that a more proportional, progressive tax structure has the support of a majority of stakeholders and believes that it represents a more equitable model for tax on acquiring property;

- The rates and bands for LBTT on commercial transactions will be set closer to the time at which they will come into force. As part of the process for setting the rates, the Scottish Government will consider ways in which LBTT might help support an attractive business environment in Scotland - for example, ways in which the tax might support SMEs and where the tax offers opportunities to encourage economic growth;

- Where there is scope to improve the legislation governing the treatment of companies, trusts and partnerships, the Scottish Government will ensure, insofar as is possible, that these improvements are made;

- Where there are references below to bringing further legislation at Stage 2, the Scottish Government wishes to make clear that it expects to liaise closely with the relevant committee during the process of preparing this additional legislation and for the committee to receive updates on progress during its Stage 1 consideration of the Bill;

- The Scottish Government looks forward to engaging further with all interested stakeholders, including Parliamentary stakeholders, in developing the proposals for the treatment of companies, trusts and partnerships under LBTT and to hearing their views on these matters.

Companies

It is the Scottish Government’s intention largely to replicate under LBTT, the way in which companies are currently treated under SDLT. This means that the rules which will determine a company’s liability for tax on its transactions will remain broadly the same as those which are currently in place. In particular, and as stated earlier in this document, the Scottish Government intends to retain group relief.

Replicating the way in which companies are currently treated under the existing SDLT system would have the advantage of continuity, in that the rules with which companies and tax practitioners are familiar would remain, broadly, in place. It would also maintain a ‘level playing field’, in terms of any comparison how the tax regime will operate in Scotland and in the rest of the UK.
102. The Scottish Government intends to bring forward at Stage 2 detailed proposals for the taxation of transfers of interest in relation to a particular class of companies that hold or deal in residential property, where the transfer gives the transferee the right to use or occupy that property. The Scottish Government believes that a transfer of the economic interest in residential land or buildings should be subject to LBTT in the same way as any other equivalent transaction.

103. There are some precedents for this approach to taxing the transfer of shares in residential property holding companies – such as paragraph 14 of Schedule 15 of the Finance Act 2003, which makes provisions for SDLT to be charged on transfers of interest in property investment partnerships and the Taxation (Land Transactions) (Jersey) Law 2009, as well as in the legal systems of Spain and New York City. However, these proposed measures represent a new approach in the UK to the avoidance of land transaction tax through the use of ‘corporate wrappers’ in respect of residential property.

104. Such a new approach needs to be carefully tested in consultation with stakeholders and tax practitioners. The Scottish Government, therefore, proposes to examine further the scope for improvement to these specific measures before presenting draft provisions to the Parliament during the legislative process.

Trusts

105. The existing SDLT legislation governing trusts is complex. For the purposes of clarity, in setting out the Scottish Government’s position on the treatment of trusts under LBTT, some background information on the nature of trusts may be useful.

106. Because many of the legal systems of the world do not have an equivalent concept to a trust in English and Scottish law, the UK and several important industrialised countries without the concept of a trust have entered the Convention of 1st July 1985 on the Law Applicable to Trusts and on their Recognition. It was enshrined in UK law by the Recognition of Trusts Act 1987. This prescribes that a trust created in accordance with principles set out in the Act must be recognised. This is read into the Bill in so far as the Bill applies to foreign trusts which have the key hallmarks of an English trust, namely having an equitable interest in trust property.

107. The key feature of a trust is that the legal ownership of an asset is held by a person other than the person or persons having the equitable or beneficial economic interest in the asset. In English and Scottish law, a trust can be created like a partnership by the actings of the parties but is almost invariably constituted or at least evidenced by writing. It is usually a tripartite arrangement by which the granter of the trust (“the truster/settlor”) sets up a trust by making a declaration of trust which, if in writing, is known as the trust deed and which stipulates the trust purposes. The trust is administered by the trustee/s, who have legal ownership of the trust funds (“the funds are vested in them”), which have been transferred to the trust by the truster for the benefit of the beneficiary/ies.

108. The current SDLT legislation divides trusts into two types: settlements and bare trusts. Settlements are straightforward, tripartite type trusts where the trustees have a discretion in relation to the administration of the trust and often who the beneficiaries are. Settlements can be further defined, for the purposes of this Bill, as trusts which are not bare trusts. Bare trusts are
trusts where either a) the beneficiary has full entitlement to the assets of the trust but for being a minor or having a disability; or b) the trustee holds the trust property as a nominee for someone else.

109. The Bill simply replicates the existing SDLT provisions on the treatment of trusts. The taxation of land transactions involving trusts under LBTT would continue to operate as it had before under SDLT. The Scottish Government’s intention in respect of this part of the legislation is to take the opportunity created by the introduction of LBTT to simplify, as far as possible, the rules in relation to the treatment of trusts under the new tax. There is support for this from stakeholders, in particular the legal community. The Law Society of Scotland is willing to engage further and in more detail with the Scottish Government and assist it in developing a simpler approach.

110. The Scottish Government will work with stakeholders during Stage 1 with a view to bringing forward simpler and clearer legislation on the taxation of land transactions involving trusts at Stage 2. The Scottish Government expects that the committee will hear evidence on the complexities of the rules in relation to the treatment of trusts under SDLT during its Stage 1 consideration of the Bill and that this will also assist the committee in coming to a view on the need and scope for improvement.

111. In relation to bare trusts of type b), the Scottish Government proposes to make the bare trustees liable for LBTT. The Scottish Government sees no compelling reason why the existing treatment of the trustees and beneficiaries in respect of SDLT – where the trustee is essentially the agent of the beneficiary with no discretion about the administration of the trust or how its benefits are distributed – should be replicated under LBTT. This change would mean that the beneficiary will have to put the bare trustee in funds before the bare trustee pays the tax on the transaction. It is intended that, in total, this will make provisions relating to trusts simpler and clearer. Provisions relating to bare trusts of type b) will be brought forward as part of the simplified approach at Stage 2.

**Partnerships**

112. The existing legislation governing partnerships and SDLT is also complex and was subject to significant criticism in stakeholders’ responses to the consultation. For example, the Institute of Chartered Accountants of Scotland said that:

“...The SDLT provisions of the Finance Act 2003...relating to partnerships...are so complex as to be virtually unworkable in practice...”

113. For the purposes of clarity, some background information on partnerships may be useful. In UK law, there are four types of partnership which might be liable to pay SDLT. These are as follows:

- General partnerships;
- Limited partnerships;
- Limited liability partnerships; and
- Foreign partnerships.
114. Broadly speaking, partnerships will transact in land or property in three different ways. There may be a transfer of land to a partnership from a partner or there may be a transfer from a partnership to a partner or a partnership may buy land from a third party. The first two types of transaction are subject to a form of relief, sometimes called ‘partnership relief’ (although it actually forms part of the rules for the treatment of partnerships under SDLT and does not appear in the existing schedule of reliefs). In the third type of transaction, SDLT is paid in the usual way. There can also be an SDLT charge on the transfer of an interest in a partnership, although this is usually restricted to Property Investment Partnerships (PIPs) where the sole or main purpose of the partnership is to invest or deal in land and property.

115. In simple terms, partnership relief is available where a partner retains an interest in the land or property transferred by virtue of being a member of the partnership. The partner is deemed not to have sold the whole of the asset but rather to have retained a share, in proportion equivalent to the number of members of the partnership – if there are four partners then it will be a quarter share and so forth. The SDLT liability arising from the transfer, is adjusted to reflect this “retained interest”. When a partnership transfers the ownership of a piece of land or property to a partner, the same principle applies in respect of the relief only in reverse – i.e. a partnership with four members would be jointly liable for 75% of the tax due, on the basis that the partner to whom the asset is being transferred had already received an economic benefit equivalent to one quarter of the asset, by virtue of being a member of the partnership.

116. The Scottish Government’s initial view is that the existing rules pertaining to partnership relief can be said to align with the principle of taxing the economic benefit of a transaction and that there may well be a need to retain these rules along with other aspects of the current treatment of partnerships under SDLT – where, in relation to normal transfers of land by a partnership from unconnected persons, the general charging regime applies, and whether or not the partnership has legal personality as in Scotland, all the partners are liable jointly and severally for the SDLT.

117. The Bill simply replicates the existing SDLT provisions on the treatment of partnerships. The taxation of land transactions involving partnerships under LBTT would continue to operate as it had before under SDLT. However, there was a broad consensus amongst stakeholders that there is both a need and an opportunity to simplify the legislative provisions in relation to partnerships. The Scottish Government agrees with stakeholders’ views on this matter and intends to carry out further work on these provisions during the Bill’s Parliamentary passage. The aim is to work with stakeholders to prepare simpler and clearer legislation that will be brought forward at Stage 2.

**Alternative approaches**

118. None were considered.
EFFECTS ON EQUAL OPPORTUNITIES, HUMAN RIGHTS, ISLAND COMMUNITIES, LOCAL GOVERNMENT, SUSTAINABLE DEVELOPMENT ETC.

Equal opportunities


120. The Government considers that the Bill does not have an adverse impact on the basis of age, sex, race, gender reassignment, pregnancy and maternity, disability, marital or civil partnership status, religion or belief or sexual orientation.

Human rights

121. Taxation is concerned with the public nature of the relationship between the tax payer and the tax authority and not with civil property rights (see *Ferrazzini v. Italy* [GC] 2001-VII, paras. 24-31) and hence ECHR is not engaged. The only point that ECHR might be triggered is in relation to penalties that might not be classed as criminal for domestic purposes. No provision for penalties is made in the Bill. The Scottish Government, therefore, considers that the provisions of the Bill have no effect on human rights.

Island communities

122. The Bill has no disproportionate effect on island communities. The Scottish Government is keen to promote a ‘digital first’ approach to the submission of tax returns by electronic means but is aware that some remote and island communities may not have sufficient broadband availability. The submission of tax returns by electronic means has, therefore, not been mandated.

Local government

123. The Bill has no disproportionate effect on local government in Scotland. The Bill proposes an amendment to the existing Compulsory Purchase relief available for SDLT. At present, the position is that a local authority does not pay SDLT if it purchases land or buildings by means of a Compulsory Purchase Order (CPO) with the intention of transferring it directly to a third party to facilitate development. The third party remains liable for SDLT if the property exceeds the minimum tax threshold.

124. The Bill proposes that the relief will be available in respect of all CPOs where the local authority transfers land to a third party, without being limited to situations where this will facilitate ‘development’. This will enable local authorities to use CPOs to purchase long-term empty homes, where the home will not be structurally altered after it is resold (and so would not attract CPO relief under the current definition of ‘development’) without having to pay LBTT. In practice, many empty homes are likely to be bought for less than the minimum tax threshold.

17 Link to consultation paper [http://www.scotland.gov.uk/Publications/2012/06/1301](http://www.scotland.gov.uk/Publications/2012/06/1301)
at which SDLT is currently payable, but this will not always be the case. The proposal to widen the relief will therefore remove one potential obstacle to local authorities seeking to bring empty homes back into use. This extension of CPO relief would be available for compulsory purchases by local authorities only, and not by other bodies with CPO powers.

125. The Business and Regulatory Impact Assessment, to be published shortly, will explain the impact on local government in more detail.

**Sustainable development**

126. The Bill will have no impact on sustainable development.
LAND AND BUILDINGS TRANSACTION TAX (SCOTLAND) BILL

POLICY MEMORANDUM


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