



**THE LAW SOCIETY
of SCOTLAND**
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A Scottish approach to taxation: Scottish Parliament Finance Committee call for evidence

**The Law Society of Scotland's response
September 2016**

Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession

We have a statutory duty to work in the public interest¹, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom governments, parliaments, wider stakeholders and our membership.

We welcome the opportunity to consider and respond to the Finance Committee's call for evidence on a Scottish approach to taxation. This response has been prepared on behalf of the Law Society by members of our Tax Law Sub-Committee.

General Comments

Over the years the UK tax system has continued to grow in complexity and compliance costs for taxpayers. Through the use of its devolved powers over taxation, Scotland has an opportunity to improve its tax system and its approach to specific taxes. Formulating good-quality and robust tax legislation requires sufficient time to properly consider proposed new, or changes to existing, devolved taxes. Our experience in relation to the Land and Buildings Transaction Tax (Amendment) (Scotland) Act 2016 (LBTT(A)(S)A 2016), which introduced the Additional Dwelling Supplement (ADS), was that the truncated timescale limited the opportunity for full consideration of the legislation. Greater scrutiny of that legislation and publication of draft legislation for consultation could have minimised some of the problems that have since arisen in practice.

¹ Solicitors (Scotland) Act section 1

In our view, Scotland has the opportunity to adopt its own approach to drafting tax legislation, rather than following the often convoluted approach of UK legislation. This could provide greater certainty and make the system more accessible for the taxpayer. We also believe that there needs to be a structured and regular timetable for tax changes. This could include, for example, an annual or less frequent, but regular, Scottish Finance Bill, through which any issues with devolved taxes could be addressed. Sufficient time should be included in the process to ensure that draft legislation can be published for consultation. Finally, we would suggest that consideration needs to be given as to how to further enhance the resources of the Scottish Government to ensure it has the skills and expertise in relation to taxation policy.

Question 1: How can the Scottish Government’s four principles to underpin Scottish taxation policy best be achieved?

Question 2: How does the current taxation regime and proposals for newly devolved taxes align against these four principles?

We have approached our response to questions 1 and 2 by considering the Land and Buildings Transaction Tax (LBTT), including the ADS, and the ways in which we believe that it does or does not align with the Scottish Government’s four principles.

Principle 1: Taxation policy should be proportionate to the ability to pay

Overall, LBTT is better aligned to the ability to pay than Stamp Duty Land Tax (SDLT). It is a progressive tax, with slices of the price charged at different rates on both residential and non-residential purchases. However, the 3% ADS, which attaches to the full consideration on residential property purchased for £40,000 or more, represents a partial return to the previous “slab” system. In previous evidence on the ADS,² we suggested that a form of taper should be introduced in order to minimise the “cliff edge” increase at the £40,000 threshold.

² <http://www.lawscot.org.uk/media/718635/stage-3-briefing-paper-land-and-buildings-transaction-tax-amendment-scotland-bill-.pdf>

Further, as a transaction tax that is payable up front, LBTT is not necessarily proportionate to the ability to pay. The lump sum that must be paid at the time of purchase can represent a considerable additional burden for prospective purchasers already incurring significant transactional costs. This could affect ability to pay, particularly in situations where the purchaser is not cash-rich and is relying on an institutional lender to meet most of the upfront costs. Lenders may be less willing to extend loans to cover such additional costs given understandable tightening of the lending market since the last recession, and demands for increased equity funding by prospective purchasers. These problems will be exacerbated if a purchaser also has to pay the ADS.

There are other factors with the ADS which do not align with ability to pay. For example, there is only a very limited workable grace period for ADS to avoid the ADS being payable where the purchaser is in fact replacing their main residence. The LBTT(A)(S)A 2016 treats a purchase as exempt from the supplement where the sale of the previous main residence is completed before the LBTT return for the acquisition of the new main residence has to be submitted. This potentially creates a grace period in these limited circumstances.

However, as we outlined in previous evidence on the ADS,³ there are occasions when a purchaser has no intention of owning two properties but, due to circumstances which might be unforeseen, the transactions do not complete on the same day. We believe that a longer grace period should be introduced to allow delayed transactions to complete without purchasers having to pay the 3% supplement where they are replacing a main residence. Such a grace period would reduce the number of purchasers faced with paying the supplement due to unforeseen consequences and would also reduce the administrative burden of reclaiming the supplement for both the purchaser and Revenue Scotland.

It should be noted that although there is a 30 day time limit for submitting LBTT returns, in practice LBTT returns for purchases of property have to be made much earlier than that. This is because the purchaser will need to submit an LBTT tax return and make arrangements to pay the LBTT in order to be able to register title to the property. We do not believe solicitors can be asked to delay submitting LBTT returns and registering title to

³ <http://www.lawscot.org.uk/media/718635/stage-3-briefing-paper-land-and-buildings-transaction-tax-amendment-scotland-bill-.pdf>

purchases of property in order to be able to treat the purchase of the new property as exempt from the supplement. Registration is key to ownership of property in Scotland. Registration is also essential from the perspective of lenders as securities cannot be perfected until registered.

Further, the replacement and repayment window for ADS is shorter than for the equivalent UK SDLT higher rates. Under the UK SDLT higher rates system, purchasers have 36 months rather than 18 months to claim a refund of the 3% supplement if they buy a new main residence before disposing of their previous main residence. Purchasers also have 36 months rather than 18 months between selling a main residence and replacing it with another main residence without having to pay the supplement. This again makes ADS less aligned with ability to pay.

It is also the case that with regard to the main rates, LBTT has a very much smaller “slice” at 5% (£250K- £325K), with the next rate being the very much higher 10%. This compares to SDLT at this rate (£250K- £925K). Given the increasing average cost of homes, this increases the tax burden at relatively low levels.

Principle 2: Taxation policy should provide certainty to the tax payer

Procedure for tax legislation

In our general comments above, we emphasised the importance of having sufficient time for consultation and scrutiny of tax legislation. We appreciate that in every tax jurisdiction situations might arise where changes may need to be made to the tax system swiftly without advance consultation. However, generally, and where there are significant changes involving complex legislation, we would welcome full discussion of principles and consultation including publication of draft legislation for consultation before the necessary parliamentary scrutiny and the eventual passing of legislation. We would also be very grateful for any procedural reform that would lead to greater certainty on when announcements for proposed changes to the devolved taxes might be made.

The UK regime works with the annual Budget and Finance Bill cycle. Each year the Chancellor of the Exchequer presents the Budget, which contains many of the tax

measures for the year ahead. Traditionally the Budget has been in March, prior to the start of the tax year on 6 April. More recently, some tax measures have also been announced in the Autumn Statement, late in the calendar year. The latter in particular often contains detailed proposals and announcements, with opportunities for consultation and draft legislation made available. It is fairly well known when these announcements are likely to be made. The statutory provisions to effect these tax measures are generally set out in a single Bill: the annual Finance Bill. The UK also has the provisional collection of taxes regime which enables the UK Government to introduce changes to tax rates and tax thresholds as well as other changes to the legislation on Budget Day prior to the Finance Bill receiving Royal Assent, subject to the House of Commons approving these measures.

We suggest that Scottish Ministers consider the introduction of an annual Scottish Finance Bill, with changes to the tax regime included in the Scottish Budget or within another fixed announcement. Providing a timescale for when the Scottish Government is likely to declare tax changes would help to ensure a greater level of certainty for the business community generally. We would also encourage Scottish Ministers to consider introducing a Scottish equivalent of the provisional collection of taxes regime which might allow for a more effective mechanism for altering tax rates in particular, although rates can generally be changed by statutory instrument affirmative resolution procedure; but a provisional collection procedure would be preferable for rates and is also extremely effective in relation to some anti-avoidance rules and militates against forestalling.

We believe that further consideration should be given to the potential impacts on the devolved taxes of tax policy changes at a UK level. With the devolution of additional tax powers, the UK and Scottish Governments will need to work closely together to ensure that both Governments are aware of what the other is doing. This is particularly important in the context of mitigating the risk of tax changes in one jurisdiction impacting on the other. The difficulties of interaction were clearly illustrated with the first announcement of LBTT rates requiring to be swiftly changed before their introduction, following the SDLT changes announced for rUK. This kind of “back and forth” process may on occasions be unavoidable, but it is undesirable.

Certainty and LBTT

Although in many respects the LBTT legislation is an improvement on the SDLT legislation, we were disappointed that the opportunity was not taken with the LBTT legislation to draft it in a simpler way which would have made it more accessible to the tax payer; instead, the convoluted approach of the SDLT legislation was largely followed. This has led to significant problems, for example, the provisions relating to partnerships and trusts are unclear and to some extent unworkable in Scots law.

There are various other examples of where uncertainty has arisen in relation to LBTT. For example, a seeding relief for property authorised investment funds and co-ownership authorised contractual schemes has come into force for SDLT this year (see section 133 and Schedule 16 of Finance Act 2016). However, it is not clear whether the Scottish Government intend to introduce such relief for LBTT. Many taxpayers are operating on a UK-wide basis and a lack of certainty about the Scottish approach could possibly deter investment in Scotland.

Another example is in relation to the penalties which are chargeable for the late submission of, or failure to submit, an LBTT return. Firstly, the information available for the taxpayer is not easily accessible. Secondly, in our view these penalties are disproportionate in relation to the errors that have been made, and are therefore unlikely to be what the taxpayer would expect. The maximum aggregate penalty for a late return will be 100% of the LBTT that was due, so the taxpayer is in effect paying double LBTT. That is just the maximum aggregate for the late return. If the LBTT itself is also paid late (which is likely if the return is late) then there will also be interest and the relevant applicable penalty for late payment. We are aware that the LBTT penalties are higher than the SDLT penalties and we believe they are excessive and should be reviewed.

Penalties are also chargeable even where no LBTT is payable, for example where a relief such as group relief is available. We are particularly concerned about the imposition of late return penalties in connection with leases. Tenants have to submit lease returns every three years, as well as when a lease is assigned or terminated, even if no LBTT is payable. We are concerned that late return penalties could be charged in relation to “no LBTT” lease returns where tenants are not aware of the requirement to submit a return every three

years. We believe the imposition of any penalty where no LBTT is payable is disproportionate and should be reviewed.

The role of Revenue Scotland

Opinions service

Revenue Scotland offers an Opinion Service.⁴ It will, in certain circumstances, provide its opinion on the tax consequences of specific transactions. Revenue Scotland's website states that this service is offered in "order to allow taxpayers to file with certainty".

We have received mainly negative feedback from members about this service. Our members have reported that, following a request for an opinion, Revenue Scotland will often state that the person has not identified an uncertainty. This response can be issued a few weeks after a request is submitted. We appreciate that a request for an opinion should be specific but our members do not experience these difficulties obtaining a substantive opinion from the HMRC. This means solicitors are often able to obtain an opinion on a matter relating to UK SDLT from HMRC but cannot get an opinion on the equivalent Scottish position for LBTT (even where it relates to the same matter and the wording in the legislation may be in exactly the same form).

It is particularly important that the Opinions Service should work well in the early days of a new tax, as guidance is still being developed, and there are areas on which no guidance has been published. One of the areas of difficulty in relation to the Opinions Service has been in areas where HMRC have issued guidance but Revenue Scotland has not, but on being asked for an opinion Revenue Scotland have advised that they do not see an uncertainty. There are also extremely strict conditions applied to the form of requests, even where information omitted (perhaps because it is simply unavailable) has no bearing on the point on which an opinion is sought.

We appreciate the existence of resource constraints, but speed of response is often essential especially in relation to commercial transactions; it is often unrealistic to expect transactions to complete without certainty as to the LBTT liability.

⁴ <https://www.revenue.scot/contact-us/revenue-scotland-opinions>

We have also been told that in a number of cases, opinions negative to a view put forward on behalf of a taxpayer have been issued without a reasoned response for the difference of view.

The opinions that have been issued by Revenue Scotland have not been published. It would be helpful to publish anonymous opinions where they cover common general areas. Revenue Scotland should, at least, provide a list of the areas where people have sought opinions and statistics on the numbers of opinions sought or issued. A programme of publishing anonymised opinions may in fact conserve resources, as we are certain that fresh opinions on the same or even analogous matters would be less likely to be sought in the knowledge of the position taken by Revenue Scotland already.

Gaps in Guidance

Similarly, there is published guidance from HMRC for certain aspects of SDLT but there is no equivalent guidance from Revenue Scotland for the same areas. This creates ambiguity and has caused difficulties for clients.

In relation to SDLT, there are some areas where HMRC has felt that there needs to be guidance. It would be helpful if Revenue Scotland could clarify if it would take the same approach as HMRC in these areas, particularly where there is no obvious reason why there would be any difference (as there is, for example, no difference in the underlying property law concepts and/or the wording of the legislation is identical or materially the same). We have reports of a number of areas, for example in relation to the meaning of 'substantial performance', where Revenue Scotland has indicated that it does not agree with HMRC's approach but has not published its own view. Taxpayers are keen to have certainty in relation to their tax affairs, and it is really essential that guidance in these areas is issued.

There are quite a large number of areas where guidance is limited or unclear – examples include the meaning of substantial performance, details for apportionments where these are required, the "Prudential" principle in contracts for purchase and construction and a significant number of questions on leases and in particular their variation (although guidance has been expanded on leases, especially on transitional issues).

Principle 3: Taxation policy should provide convenience/ease of payment

Overall, we believe that Revenue Scotland has been successful in administering and collecting LBTT. Our members have found the SETS online system easier to use than the HMRC SDLT system. It requires much less information to be provided than the SDLT online system, and all the information is relevant to the tax which some of the SDLT information is not. It is possible to amend LBTT returns online and to submit returns in advance, which is not possible for SDLT returns.

The publication on a monthly basis of Revenue Scotland's aggregated figures for LBTT and ADS is very helpful. However, it would be helpful to have more detail on these figures such as LBTT broken down by band, and by lease take and purchase take. This would further enhance transparency and allow for proper consideration of the impact of the tax on Scottish taxpayers.

Principle 4: Taxation policy should be efficient

We have significant concerns relating to the efficiency of LBTT is in relation to cross-border transactions. The differences between LBTT and SDLT, which will both have to be paid in such transactions, have made such transactions more complex for the taxpayer.

Changes could be made to enhance efficiency in relation to the three-yearly review of leases. An LBTT return should not be required after three years where there has been no substantial change. Further, we understand that Revenue Scotland does not intend to issue reminders about lease returns and, particularly as the LBTT lease regime is a change from SDLT, people not familiar may not make the returns and then suffer a penalty even if there is no LBTT to be paid.

Question 4: Should future tax changes be ring-fenced and if so, how? If not, why?

We do not object in principle to the hypothecation of taxes. However, whether it is appropriate will depend on the type of tax, the areas chosen for hypothecation and how it is proposed to work in practice.

Question 6: To what extent do the mechanisms for administering the Scottish income tax system via HMRC limit the scope for a different tax system in Scotland to develop?

As only powers over rates and thresholds have been devolved, we do not think that it would be efficient for Scotland to have its own system for administering the Scottish income tax. However, the amount of Scottish income tax collected will depend on HMRC practice and therefore intergovernmental relationships will be crucial. In particular, Scottish Government access to relevant HMRC data will need to be improved so that the Scottish Government can have greater confidence in the amount of Scottish income tax collected. The HMRC Annual report should in particular contain a chapter on devolved taxes.

Question 7: Are there any other administrative limitations to the emergence of a Scottish tax system?

Sufficient resources need to be in place to support the emergence of a Scottish tax system. Potential limitations include: continued austerity and a lack of funding to support the new system; limited technical expertise within the Scottish Government and the need for resources to support and train those working in the new system.

For further information and alternative formats, please contact:

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