Revolution in the Making

Long-awaited taxation powers for the Scottish Parliament are signalled with the publication of the Scotland Bill. What new challenges will it create for Scotland’s legal professions? Fred Mackintosh highlights the far-reaching implications of the bill

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The creation of the Scottish Parliament was welcomed by those who wanted to see the back of Law Reform (Miscellaneous Provisions) (Scotland) Acts and saw the potential for informed local law reform. Of course not everyone has welcomed every piece of legislation from Holyrood, but no one can say that Scots law has not changed from the stale and static creature of the pre-devolution years. Will the changes to the original 1998 Scotland Act set out in the new Scotland Bill open the door to similar creative work on taxation in the Scottish Parliament?

It is worth remembering that on 11 September 1997, 63.5% of those voting in the Scottish Parliament referendum voted for the Parliament to have tax varying powers; and yet in recent years 87% of the combined budget of the Scottish Government and Scottish local authorities has come from Whitehall in the form of block grant. Why has there been a consensus against the use of the Scottish variable rate (SVR) created by the Scotland Act 1998? In all that time there have been only two suggestions to use the SVR: a proposed cut in income tax by Tavish Scott MSP in 2007, and a proposed increase by Patrick Harvie MSP this year.

The answer is not hard to find: a decade of increasing budgets since 1999 meant there was little need to consider the use of the SVR. If Scottish Ministers did nothing they got more money, year on year. Why incur the unpopularity of using the SVR to raise a few hundred million a year when the Scottish block grant was then increasing by between £1 billion and £2 billion each year as UK public spending increased?

Defining Scottishness
The Scottish rate for Scottish taxpayers proposed in the Scotland Bill is different. Scottish ministers will no longer be able to sit back, do nothing and watch the money roll in from the block grant. If the Scottish Parliament fails to make a “Scottish rate resolution”, as defined by what will be s 80C of the amended Scotland Act 1998, the Scottish rate will not believed and the income from that tax will not come either. A decision will have to be made and responsibility taken every year, before the start of the tax year and probably at the time of the Scottish Budget in November.

The coalition Government appears to have attempted as much as possible to limit divergence between the system of income tax collection in Scotland and the rest of the UK. By amendment to s 6 of the Income Taxes Act 2007, the setting of the Scottish rate will cause an adjustment to the basic, higher or additional rates of income tax for Scottish taxpayers. No additional band or bands are created and only the Scottish rate is to be controlled by the Scottish Parliament. No doubt to the relief of many in Scotland’s financial services sector, the Scottish rate will not apply to income from savings or dividends.

Perhaps the most challenging aspect of the income tax proposals for those in practice will be the definition of “Scottish taxpayer” – by new ss 80D, 80E and 80F in the amended Scotland Act. This new definition builds on the previous definition – in
the soon-to-be repealed s 75 – and will inevitably require taxpayers and employers to collect and retain the additional information that will be required to decide whether a particular taxpayer is a Scottish taxpayer.

Fortunately for most Scottish taxpayers, the question will be cut and dried. They will have one home – in Scotland – and live there for at least part of the year. Those who have only one home – in Scotland – but work elsewhere in the UK will, it appears, be Scottish taxpayers. The issue has the potential to be particularly complex for those who have a home in Scotland and one elsewhere in the UK. In those cases, the number of nights spent in Scotland – as opposed to England, Wales or Northern Ireland – will become an issue of some importance. At present, there are relatively few solicitors and advocates in Scotland who work in the field of residence for tax purposes, but that will have to change, as we get closer to the expected first Scottish rate resolution in November 2015.

Starting from scratch
Of course, the Scotland Bill will not just affect income tax. In fact the changes proposed to stamp duty land tax and landfill tax have the potential to be significantly more radical and disruptive. While the income tax changes create the potential for perhaps the most challenging aspect of the income tax proposals for those in practice will be the definition of “Scottish taxpayer” – by new ss 80D, 80E and 80F in the amended Scotland Act January 2011 individuals to pay a different amount of income tax because they are Scottish taxpayers, stamp duty land tax and landfill tax will be entirely devolved.

In Command Paper 7973, accompanying the bill, the UK Government has signalled its intention that these two taxes will cease to apply in Scotland from April 2015 and the Scottish Parliament will then be able to levy its own taxes in respect of land transactions and disposals of waste to landfill in Scotland. Two new taxes will have to be created to fit into the autonomy devolved to the Scottish Parliament in what will be chapter 3 and chapter 4 of part 4A of the amended Scotland Act.

A Scottish land transaction tax could well be a significantly different beast to the existing SDLT. There will be no obligation on the Scottish Parliament to – for example – provide a first-time buyers’ exemption, restrict the transaction tax to leases of seven years or more in all cases, or retain the current rules about the treatment of the interest of a beneficiary under a trust. Many practitioners and those in the commercial and residential property sectors will of course be interested in lobbying for the new land transaction tax to recognise the peculiarities of the Scottish market, but other factors will be at play in what will be a fast-moving decision.

For those in the commercial property sector there will be a concern that the Scottish Parliament will soon have under its control both property transaction tax powers and the Scotland-wide system of non-domestic rates. Ireland will be introducing a land value tax from 2013, and the new Scottish land transaction tax system would potentially provide the framework to collect the land values required for a land value tax. The lack of such a valuation mechanism has always stumped proposals for site valuation rating-based taxes in the past.

In the area of landfill tax, the Scottish Government has already instructed research on the options for setting a Scottish landfill tax and the impact this will have on waste policy and plans for a zero waste society. Given the tax’s close policy link to
waste management within Scottish and local government, we should expect to see early movement on this area once Royal Assent is achieved.

The bigger picture
The Scotland Office expects the powers to levy these two taxes to be available for use from April 2015, and to meet that deadline the legislation to create two new Scottish taxes will have to have been drafted, consulted on and then put through the Parliament to receive Royal Assent in the next couple of years.

Of course these new tax powers for the Scottish Parliament will not exist in a vacuum. EU state aid questions are important when tax rates vary within a member state, and the changes to the financial arrangements between the Scottish authorities and the UK authorities envisaged in Command Paper 7973 are clearly designed to ensure that article 87 of the EC Treaty is not breached.

The example of the aggregates levy is instructive and reminds us all that that EU law seeks to prevent tax discrimination between domestic products and imported products originating elsewhere in the EU. The Calman Commission had recommended that this levy be devolved to Scotland, but that proposal has fallen foul of a challenge by the British Aggregates Association to the levy in the European Court of Justice. The court recently struck down the Commission’s approval of the 80% rebate that operates in Northern Ireland (British Aggregates Association v Commission [2010] All ER (D) 46) on the basis that the different treatment of aggregates imported to Northern Ireland from the Irish Republic from those mined in Northern Ireland was a breach of the provisions of article 87. As the Scottish Government considers how to tax disposals of waste to landfill without creating cross border waste flows on the back of a differential tax system, the example of the aggregates levy should not be far from all our minds.

The next five years will see a level of unprecedented change in tax law for Scottish residents and Scottish companies, but the changes we know about now are only part of the story. In what will be s 80B of the Scotland Act the Scottish Parliament will acquire the power to create new, as yet undefined taxes with the consent of the Westminster Parliament. Pre-legislative tests will be applied by the Treasury to consider whether a new tax would create economic distortions and arbitrage within the whole UK, whether it would increase tax avoidance or compliance costs, and whether it will be compliant with EU obligations such as state aid. We can’t yet know what new taxes future Scottish Parliaments will seek to create in the years to come, but the days when Scottish tax law was stuck with the fiscal equivalent of the Law Reform (Miscellaneous Provisions) (Scotland) Acts are gone for good.