

**A SCOTTISH APPROACH TO TAXATION: SCOTTISH  
PARLIAMENT FINANCE COMMITTEE CALL FOR EVIDENCE**

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(Responding in a personal capacity)

## Introduction

I 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 an entirely personal basis and is not made on behalf of Brodies LLP or the University of Edinburgh. I have also contributed to the response prepared on behalf of the Law Society as one of the members of their Tax Law Sub-Committee.

## General Comments

Any comment on a Scottish approach to taxation must start with an acknowledgement of the context in which such an approach must operate. At present, Scottish taxation is a devolved matter, to the limited extent that it *has* been devolved. This might almost inevitably appear to lead to the conclusion that the system cannot diverge too greatly from that of the system from which it has devolved. Indeed, where partial devolution of a single tax is considered (such as income tax), that will certainly be the case. With more fully devolved taxes (such as LBTT), there is an argument that divergence should be kept as limited as possible, on the grounds of efficiency and greater understanding and acceptance by taxpayers.

But adherence to some of the methodology adapted at Westminster for tax legislation seriously militates against attempts at a distinctive Scottish approach; and thus far adherence seems to have been the rule rather than the exception. There was an opportunity with Land and Buildings Transaction Tax to adopt a genuinely new approach; and that opportunity has not been taken, for the most part. (In relation to existing taxes, my comments will be particularly directed at LBTT, as that is where I have some knowledge and practical experience. The limited devolution of income tax makes such consistency, on principles at least, inevitable for the moment.)

What has therefore happened is that at present the divergences that have occurred in relation to Scottish taxes appear to some extent as further complications in what overall is seen (with great justification) as the most complicated tax system in the

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world. This is not an over-emphasis – the UK tax system as a whole is woefully complex. This is often acknowledged and lip service to its possible reform is paid - but virtually nothing is done about it. Then temptation to use tax as an economic and political lever may be too great to allow any political party to grasp this particular nettle.

A distinctive Scottish approach might approach this problem with a real willingness to make radical changes towards simplification – such efforts would accord exactly with most of the avowed principles of the Scottish approach.

Indeed, so far, there are some signs of the opposite happening – with Scottish taxes seen as bringing an additional layer of complexity to the overall system. In fact, this appearance may be more pronounced where there are *slight* divergences in rates, rules or practices which apply to the rest of the UK. There may be little justification for this unless a distinct economic or other effect is produced by the divergence.

A Scottish approach, adhering to the principles set out to demonstrate such an approach, might be achieved by a wholly different approach to enacting tax legislation. It is said that there are no principles in taxation – the law is the law in its minute complexities and if a taxpayer falls within the specific wording it s/he is charged, while a taxpayer falling outwith the exact words is not so charged.

But there is no reason why principle should not be applied to taxation; and indeed the Scottish Anti-Avoidance Rule could be seen as an example of that approach. But one fears that it will be explored in relation to the details of its specific wording in attempts to limit – or indeed expand – its boundaries. Its effects will not be clear until the first litigation on its terms, but an approach concentrating even more on the principle of the taxation intended might leave less room for doubts than currently exist.

There remains a real opportunity for such a radical approach - with a basis in a difference often put forward in relation to Scots law more generally. It is a system based on principle rather than the vagaries of case law. While such an assertion may be a little trite and is certainly not uniformly seen in Scots law, it is an approach worth

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preserving into tax legislation. It can and does apply in other areas of legislation – the ground-breaking Adults with Incapacity (Scotland) Act 2000 virtually commences with a selection of principles to be applied and that underlying approach to the details of the Act produces a welcome and workable system.

In my view, a significant amount of perceived problems already becoming evident in Scottish tax law derives from accepting what might be seen as an old fashioned form of drafting tax legislation deriving from Westminster. Our most significant piece of substantive tax legislation, the Land and Buildings Transaction Tax (Scotland) Act 2013, involved utilising unchanged a considerable proportion of the analogous stamp duty land tax legislation. The same applies to significant amounts of the Revenue Scotland and Tax Powers Act 2014. Constraints of time and resources may have made such an approach inevitable; it may nonetheless be seen as a little disappointing.

Reference might be made to the tax Law Re-Write project, which was applied to some (but not all) UK tax legislation between 1997 and 2010. This was widely perceived as not being particularly successful; and its abandonment before completion left the UK tax system with two distinct parents in stylistic form – re-write style and traditional style. My (admittedly anecdotal) experience of the two different styles of drafting is that it was not attractive to current and experienced users of the system; but that people (in this case students) coming to tax legislation for the first time much preferred the new style of drafting.

In any event, I believe that serious consideration should be given to the drafting of Scottish tax legislation; and that in particular it should not be considered automatic that it should follow its Westminster predecessors in style or in substance.

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

This has to some extent been dealt with in my introductory remarks; and is further addressed in the answer to question 2

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

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

The original announcements in relation to LBTT and indeed the main plank of Scottish difference from its SDLT predecessor pointed towards immediate adherence to this principle – the abolition of the notorious “slab” or “cliff-edge” system for the rates of the tax and its replacement by a “slice” system. (The “slab” or “cliff-edge” system involves payment of the relevant tax rate on the *whole* consideration once a threshold has been breached; the “slice” system involves charging at the lesser rates up to each threshold and at the higher rates only on the slice of consideration above that threshold.) The impact of this welcome and radical change was somewhat diluted by the same principle being adopted in rUK at the same time as LBTT was introduced. This should not detract from that important starting point – such a system is clearly directed at proportionality to the ability to pay.

Unfortunately, the recent introduction of Additional Dwelling Supplement has detracted somewhat from that welcome change. ADS is charged on a slab system – once one is over the very low £40,000 threshold, the tax is payable on the whole consideration. Indeed, if it does not stretch the metaphor too far, there is a double cliff edge in the ADS system, as that £40,000 threshold applies absolutely not only to the property being purchased, but also to the other property owned which causes ADS to apply.

Thus if a property is purchased for £39,000 and ADS would otherwise apply, there is no ADS payable. If the property is purchased for £40,100, ADS rises from £0 to

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£1,203. If one is purchasing a first property for £1 million and owns another property worth £39,000, there is no ADS payable. If the other property is worth £40,100, the ADS on the new purchase is £30,000. It is a high cliff and it is unsurprising that taxpayers will take action to avoid falling off it.

It may reasonably be argued that ADS has less need to involve proportionality, as by definition it involves second properties, but as a matter of principle a “slab” system can rarely contribute to proportionality.

In relation to the limited proposed changes to Scottish rates of income tax (in fact thresholds rather than rates, with the exception of what will be a 0% rate for a small amount to extend what is in effect the personal allowance), they are a relatively minor contribution to proportionality. They might fall within a criticism as being minor differences for no strong economic reason, but they are in fact anticipated to produce quite a significant amount of overall additional revenue; and despite their addition to the complexities of the system, they may not be different *enough* to produce adverse behavioural effects.

I endorse the further specific points put forward by the Law Society of Scotland in their response.

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

In the vast majority of simple cases, there will be certainty for the taxpayer in relation to the LBTT to be paid on a transaction. This must be recognised and acknowledged. Despite the “slice” system being more complex than the “slab”, the availability of online calculators effectively eliminates that level of additional complication.

But once one moves beyond the basic transaction, including into any transaction potentially liable to ADS, a degree of this certainty disappears. Examples are numerous - the entire regime for partnerships is complex (and in some cases illogical); there are difficulties with trusts; transactions relating to leases, particularly their variation, extension and restriction and especially where the original lease dates

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from before the introduction of LBTT, do not produce certain results (although guidance has been extended on this matter).

These problems derive to some extent from the fact that the LBTT legislation was imported from its SDLT equivalent without changes. In the case of partnerships, the importation was without a single alteration of a regime that has attracted criticism in its current form for SDLT. In relation to trusts, the importation was somewhat odd, in that in new **Scottish** legislation, one is directed to consider whether a beneficiary has an interest that would have a particular effect under the law of England and Wales, before deciding whether and how LBTT is chargeable.

The introduction of ADS has decreased the level of certainty for a taxpayer. There are a number of distinct examples where what would appear to the principles of the charge are violated to a significant extent.

One example will suffice for present purposes. If one of a married couple (A) own their current main residence and the other (B) owns a holiday home, they may decide to sell their current main residence and buy a new one, this time in joint names. It would be expected that this will simply involve the couple replacing their main residence and no ADS should be charged if the purchase takes place after or at the same time as the sale. That is not the case – B does not own a main residence and so cannot replace it; and B's ownership of another property is deemed to extend to A, so that the whole transaction is liable to ADS. This offends against the principle of certainty, but also those of proportionality and probably efficiency (as essentially artificial action may be necessary overcome this surprising result.)

On a policy level I endorse the comments of the Law Society of Scotland, particularly in relation to reform of the tax making process; and the need for a regular Finance Bill to include reforms to existing legislation as well as new proposals.

On an operational level, I endorse the comments from the Law Society of Scotland in relation to the Opinions service offered by Revenue Scotland (improvements in delivery and in particular publication of opinions in some form would be very much welcomed.)

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Guidance could also be improved, but I recognise that this is very much a work in process; and that great advances have already been made in the guidance available.

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

This principle has generally been adhered to. Increased and now almost universal use of electronic communication for LBTT compliance and increasingly for payment has assisted greatly. This has involved a high degree of cooperation by Scottish solicitors, which has been generally acknowledged. The LBTT online system is generally excellent, with some simplification as compared to its rUK equivalent. The adoption of sensible arrangements in relation to the payment of LBTT so as not to delay registration of deeds was extremely welcome and is an example of a necessary recognition of the practicalities required which was not apparent from the underlying legislation.

***Principle 4: Taxation policy should be efficient***

There need to be significant advances in the system for legislation before tax policy itself could be regarded as efficient. Good tax policy requires acceptance of its aims by the widest possible constituency of interests; and that takes time for consultation. It is appreciated that there is sometimes a conflict between the need or wish to enact tax changes swiftly and the time needed to enact what may be complex law, but the best system would involve full consultation and in particular a willingness to accept comments on draft legislation offered in the spirit of achieving the efficient implementation of tax policy.

It is appreciated that there may be difficulties in sharing details of intended policy. There is a relatively small pool of individuals in Scotland with interest and expertise in these matters, most of whom have other responsibilities. But there is I believe a genuine willingness to assist with the implementation of policy in the most painless fashion if that is possible. It will require goodwill, openness and trust on both “sides” of this small community to maximise the benefits of this cooperative approach.

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**Question 3: Is there scope for a fundamentally different approach to taxation in Scotland?**

This has largely been answered above. I believe that there is such scope,

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

Hypothecated taxes have a tendency to start in that form, but with a gradual move back into general tax receipts. But in principle there is no reason why hypothecated taxes cannot form part of an overall system. It is perhaps more appropriate that hypothecation for a particular purpose is time limited, although there is no reason why that purpose should not change from time to time.

**Question 5: To what extent do potential behavioural responses limit options for tax changes in Scotland?**

As part of a larger single state, Scotland is particularly exposed to the possible mobility of taxpayers in response to raised taxes. But it is possible that this danger can be exaggerated; and it is of little bearing in relation to taxes in which the connecting factor is permanently located in Scotland (such as, most obviously, land). But other behavioural responses may be anticipated where (for example) there is the possibility of investment suffering lower taxes in Scotland's contiguous neighbours.

**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?**

While devolution is restricted to rates, the administration of income tax by HMRC should not limit the scope for change. But if other aspects of income tax were to be devolved it would be very difficult for a single tax authority to administer parallel but differing tax systems.

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

The resources and personnel available to Revenue Scotland and indeed the Scottish Government in relation to tax matters often seem stretched. It is a truism to say that the creation and administration of a tax system is no small undertaking; and as it develops, it is impossible to think that more resources will not be required. It is hoped that this will contrast with the position of HMRC, where contracting resources are currently causing serious administrative difficulties for users of the tax system.