In less than four months, Scottish residents will head to the ballot box, to vote on whether Scotland should remain part of the UK. If the latest opinion polls are right, the outcome could be a very close run thing: we could well wake up on Friday 19 September to find that Scotland is headed for independence, or that a narrow “No” vote leads to pressure for more extensive devolution of tax powers to Scotland.

What tax issues will businesses have to grapple with if Scotland votes for independence? (These will obviously extend far beyond a new-found ability, for those of us who have moved across the Tweed, to claim non-domiciled status for the first time.) In this article, I want to flag the principal issues. First, what challenges will arise from the break-up of the UK itself, and the fact that UK businesses will find themselves operating in two independent countries? Secondly, what do we know about the business tax policies which would be implemented in an independent Scotland?

As John Kay recently argued in the Financial Times, even the most blinkered tax adviser will not go to the ballot box to express concerns about corporation tax group relief. However, many businesses will want at least to start thinking about the implications of Scottish independence soon. If Scotland votes “Yes”, there will be much to resolve in a short time, as the SNP has already chosen 24 March 2016 as Scottish “independence day”, a mere 18 months after the referendum itself.

DEALING WITH THE BREAK-UP OF THE UK

Companies operating cross-border. Companies which currently operate on a UK-wide basis will, obviously, find that they are operating under two different tax systems. A company which remains resident in rump UK (“rUK”), for instance, may have a Scottish permanent establishment after independence – and would need to start dealing with two different tax authorities, and agreeing an apportionment of profits between the Scottish PE and the rUK business. Companies in this position may want to consider a branch exemption election, to benefit from the possible lower rate of Scottish corporation tax. Alternatively, companies could hive their Scottish business into a new company which will be Scottish tax resident: if this is done pre-independence, it appears this could be accomplished on a no-gain, no-loss basis, with no exit charge upon independence.

Dual resident companies. Many groups will have companies which were incorporated in Scotland, but are managed and controlled in rUK (or vice-versa). These companies will become dual-resident after independence. And, until a double tax treaty is agreed between Scotland and rUK, there would be no tie-breaker to allocate the company’s residence between the two territories.

Withholding taxes on cross-border payments. Interest and royalty payments between rUK and Scotland would become subject to withholding tax, unless and until a double tax treaty is agreed providing for zero withholding.

Tax treaty needed between Scotland and rUK. As the two points above make clear, it is imperative that Scotland and rUK agree a double tax treaty very quickly – if possible, before independence day itself. Doing this in 18 months may be challenging, especially if (or when) negotiations over currency union, divisions of national debt etc become fraught.
Double tax treaties between Scotland and other countries. In the independence White Paper, the Scottish Government stated that double tax treaties between the UK and other countries would continue to apply between an independent Scotland and those other territories. But can Scotland really force other countries to apply their UK tax treaty to a newly independent Scotland? Although the Vienna Convention on Succession of States in respect of Treaties would allow (indeed, require) Scotland to participate in all of the UK’s existing double tax treaties, that Convention has not been ratified by the UK or any of its major trading partners. And several countries – notably the US – have agreed to treaty provisions with the UK which they have refused to grant to smaller countries. They may well be unwilling to extend those favourable provisions to a newly independent Scotland.

Losses. Businesses are, of course, currently able to set off losses incurred in England against profits in Scotland (or vice-versa). Where the English losses and Scottish profits are in the same company, this loss relief simply occurs automatically. Where the businesses are in different companies, then English-Scottish group relief works in exactly the same way as English-English group relief. After independence, this will obviously change. English losses can be offset against Scottish profits within the same company only if the loss is incurred in a (taxable) permanent establishment of a Scottish resident company. And, even if Scotland is admitted to the EU – another debate entirely! – group relief would be available between Scotland and rUK only if the Marks and Spencer “no possibilities test” is satisfied. These changes would plainly increase the risk of finding losses stranded on the wrong side of the Tweed.

Indirect tax issues. Creating a new border between Scotland and England would, naturally, raise indirect tax issues along with the direct tax matters above. Companies in Scotland would no longer be able to form a VAT group with companies in rUK, making a wide range of intra-group supplies subject to VAT, and leaving groups with an extra set of VAT returns to produce. Given the level of trade between Scotland and rUK – and its relative importance for the Scottish economy in particular – it may be that the SNP push for the introduction of a pan-UK VAT system, akin to the “Mini One Stop Shop” for broadcasting, telecommunications and e-services, under which businesses can register in either Scotland or rUK, with an allocation of the resulting VAT between HMRC and Revenue Scotland. Any such proposal will be difficult to agree with rUK – but, without it, cross-border trade will be subject to the sort of transaction costs which have already prompted the SNP to push for a currency union.

Systems issues. Equally obviously, businesses operating in both rUK and Scotland will have to get used to dealing with two tax compliance systems rather than one – on PAYE and NICs for example.

SCOTTISH CORPORATE TAX POLICY

So much for the tax implications arising directly from a break-up of the UK. What can businesses operating in Scotland expect in terms of future corporate tax policy?

Immediately after independence, the short answer is that Scottish tax law will be identical to that in rUK. The SNP have confirmed that an independent Scotland would initially inherit the UK’s existing tax system – rates and base – rather than making any changes as part of the independence process itself.

It is generally thought that an independent Scotland will have lower corporation tax rates than rUK. Indeed, the SNP argued in 2011 that reducing the Scottish corporation tax rate by three percentage points below the rUK rate would create 27,000 Scottish jobs. It is a little surprising, therefore, to find that the independence White Paper merely commits Scotland, by the end of the first independent parliament (i.e., by 2020), to produce a “clear timetable” for reducing the headline rate of Scottish corporation tax.

The independence White Paper, and the economic policy document published shortly beforehand (Building Security and Creating Opportunity: Economic Policy Choices in an independent Scotland) are, however, replete with proposals for specific tax incentives. These include National Insurance reliefs to encourage employment, reliefs and preferential tax rates to encourage innovation (but, oddly, no discussion of the fact these already exist in Scotland through R&D
allowances and the patent box), and possible sector-specific reliefs for oil and gas, aviation, manufacturing, video games and tourism. In the current political climate, however, it is hardly surprising that there are no proposals for reliefs supporting Scotland’s financial services sector.

How will all of this be paid for? The White Paper argues that Scotland will bring in an extra £250 million a year by 2020, by simplifying the tax system "to streamline reliefs and help to reduce tax avoidance". However, the White Paper and the economic policy paper list only specific relief which will go: the "shares for rights" scheme introduced in Finance Act 2013.

The proposed "Scottish GAAR", currently before the Scottish Parliament in the Revenue Scotland and Tax Powers Bill, provides a much greater insight into how an independent Scotland might seek to challenge tax avoidance. The Scottish GAAR is currently intended to apply only to the devolved taxes: landfill tax, and land and buildings transaction tax. However, it is likely to be extended to all taxes post-independence.

The drafting of the Scottish GAAR is based closely on the UK GAAR. However, the Scottish Government have been at pains to state that it is a general anti-avoidance rule, rather than a general anti-abuse rule. It differs from the UK GAAR in three principal ways. First, the “double reasonableness” test is replaced with a single reasonableness test, in which a tax arrangement can be attacked under the Scottish GAAR if it “is not a reasonable course in relation to the tax provisions in question”. Secondly, tax arrangements which pass the reasonableness test can nevertheless be attacked under the Scottish GAAR if the arrangement “lacks commercial substance”. And, thirdly, there is no GAAR Advisory Panel. Taken together, these changes remove most of the safeguards which were included in the UK GAAR as an attempt to strike a balance between revenue protection and taxpayer certainty. In the Scottish Government’s consultation on the Scottish GAAR, these extensions were opposed by 72% of those responding, and were supported by nobody. However, there appears to be no sign that the Scottish Government will change course.

WHAT NOW?

For some businesses, the right position at this stage will be to watch and wait. The referendum is less than four months away, and few tax departments will want to devote significant time now to an event which is still likely to be (marginally) defeated at the polls. Nevertheless, there may be only 18 months between the referendum and independence itself, so groups with much disentangling required between their Scottish and rUK businesses may want to start planning for this now. Finally, the ongoing debate over the Scottish GAAR should get more attention than it has received so far. It is tempting to think that this debate is limited to the narrow range of devolved taxes, but the wide remit of the Scottish GAAR is likely, post-independence, to apply to all taxes in Scotland.

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