

POLICY NOTE

THE NON-DOMESTIC RATES (MISCELLANEOUS ANTI-AVOIDANCE MEASURES) (SCOTLAND) REGULATIONS 2023

SSI 2023/XXX

The Scottish Ministers make the following Regulations in exercise of the powers conferred by section 37(1) and (3) of the Non-Domestic Rates (Scotland) Act 2020 (“the 2020 Act”) and all other powers enabling them to do so. In accordance with section 41(2) of the 2020 Act the Scottish Ministers have consulted such persons appearing to them to represent the interests of local authorities and assessors as the Scottish Ministers considered appropriate, together with such other persons as they considered appropriate, have notified the Scottish Parliament about the consultation, and have had regard to representations received. The instrument is subject to affirmative procedure.

Purpose

The Regulations have the purpose of making provision to prevent or minimise advantages arising from artificial avoidance arrangements in relation to non-domestic rates. Artificial avoidance arrangements in relation to non-domestic rates are defined in sections 38, 39 and 40 of the 2020 Act.

These Draft Regulations prescribe the circumstances in which the owners of lands and heritages, rather than the occupiers, are to be treated as liable to pay non-domestic rates and the circumstances in which any relief (reduction or remittal) in relation to non-domestic rates for those lands and heritages is to cease to be available (Part 2). They also prescribe the circumstances in which changes to lands and heritages causing a reduction in rateable value are to be disregarded (Part 3).

The Draft Regulations also set out the process for notification of the owner in relation to Part 2 and 3, which includes an opportunity for the owner to make representations to the local authority before a final determination is made.

Policy Background

The Scottish Government is committed to a fair and transparent non-domestic rates system, one that is not undermined by avoidance tactics, and in which local authorities are empowered to tackle known avoidance tactics.

The Bute House Agreement, and the Programme for Government 2021, committed to using the anti-avoidance powers in the 2020 Act to assist local authorities in tackling known non-domestic rates avoidance tactics, including when they make decisions on applying empty property relief (which will be devolved to local authorities on 1 April 2023) and charity relief.

Tax avoidance in the context of non-domestic rates takes place when a ratepayer seeks to reduce, delay or avoid the tax liability by taking action(s) which, although permissible within the existing legal framework, is (are) not in keeping with the spirit of non-domestic rates

legislation. Tax avoidance often involves artificial mechanisms for which the main reason, or one of the main reasons, is to reduce the tax due.

Tackling this avoidance is important because it reduces public revenues, and it is unfair to the majority of ratepayers who do not engage in avoidance. Avoidance can also undermine public confidence in the non-domestic rates system and lead to reduced rates of compliance.

The independent Barclay Review of Non-Domestic Rates recommended that a General Anti-Avoidance Rule be created to reduce avoidance and make it harder for loopholes to be exploited in future. The 2020 Act empowers the Scottish Ministers to make regulations with a view to preventing or minimising advantages arising from non-domestic rates avoidance arrangements that are artificial.

These draft regulations, made under Part 4 of the 2020 Act, seek to empower local authorities to tackle known avoidance tactics. The following are the observed types of avoidance behaviours that are covered by these regulations:

Avoidance Through the Transfer of Liability to a Third Party

Perhaps the most common feature of avoidance in the non-domestic rates system is the shifting of liability to a third party (through sub-leasing). Sometimes the occupier taking on the liability has a connection to the owner of the non-domestic property, but not always.

The new liability holder may have certain characteristics which would facilitate the obviolation of a non-domestic rates liability (e.g. a company with no assets).

Leasing

The ‘artificial’ leasing of a property is a feature in a number of avoidance practices including in non-domestic rates. Following the ‘artificial’ leasing of the property, the owner or tenant (sub-tenant) will then seek to take advantage of the company insolvency, tenant and/or a non-domestic rates relief, or in order to reduce or remove their rates.

Leasing and Reliefs

Where a national non-domestic rates relief is available mandatorily (i.e. a national relief made available on the basis of the presence of specific criteria), the council obviously has limited scope for discretionary refusal. This includes where a Local Authority may suspect manipulation or abuse, through an artificial arrangement, in order to meet the criteria of a relief, and the avoidance of non-domestic rates liability.

Insolvency and Phoenix-ing

In conjunction with ‘artificially’ utilising a lease arrangement, ‘phoenixing’ has been observed in the non-domestic rates system. This practice involves the owner or tenant of a premises leasing or sub-leasing the property to another company. Typically, this other company is a Special Purpose Vehicle company with little to no assets, which then becomes insolvent and is wound up either by a court order or voluntarily. The non-domestic rates liability is then generally not recoverable by the council, given the lack of any assets to recover. Throughout this activity, the business operation taking place at the premises may never change.

Physical Changes to Premises

Another method of avoidance is where physical changes are made to a property for the purpose of reducing or removing a rates liability, making it unfit for beneficial occupation, in its entirety or to some extent, thereby reducing the rateable value.

Particularly with the devolution of Empty Property Relief on 1 April 2023, local authorities require powers to prevent or minimise artificial action of this nature should it arise.

Policy Objective

The overarching policy objective of these regulations is to set to prevent or minimise advantages arising from non-domestic rates avoidance arrangements that are artificial.

A non-domestic rates “advantage” may include the following:

- avoidance of a possible assessment,
- remission,
- relief (or increased relief),
- repayment (or increased repayment),
- deferral of a payment or advancement of a repayment.

In determining whether a non-domestic rates avoidance arrangement has resulted in an advantage, regard may be had to the amount of non-domestic rates that would have been payable in the absence of the arrangement.

For any activity captured by these regulations, there requires to be a non-domestic rates advantage.

Part 2 - Treatment of owners as liable to pay non-domestic rates

Part 2 of the Regulations prescribes circumstances where owners of the lands and heritages are to be treated as liable for payment of non-domestic rates, where the occupier would otherwise be liable to pay non-domestic rates. This will mean that the occupier will be considered not to be the ratepayer in respect of the relevant lands and heritages in such circumstances.

It is to be noted that Part 2 of the draft regulations will only apply to tenancies or other arrangements entered on or after the regulations come into force (1 April 2023).

The effect date for the transfer of liability will be from the point of notification, or if it is a repeat offence from a prior one that has occurred within the last 5 years, then the council may do a retroactive transfer of liability (including outstanding liability) from the start of any lease agreement (or the date of the first final notice – see below).

The circumstances where liability may transfer as set out in Regulation 4 are described in **A**, **B** and **C** below.

A. Tenancy is not on a ‘Commercial Basis’

One of the characteristics of avoidance in the non-domestic rates system involves tenancy agreements purposefully designed to facilitate the avoidance of liabilities. Such agreements have common features which distinguish them from other legitimate leases entered into for a legitimate commercial reason.

The circumstances for the tenancy not being on ‘commercial basis’ are set out below:

- there has been no change to the occupation of the lands and heritages since the tenancy or other arrangement took effect,
- the lands and heritages are being occupied by a person or body other than the person or body named in the tenancy or other arrangement,
- payment of the rent for the lands and heritages is optional in terms of the relevant tenancy or other arrangement,
- the rent charged for the lands and heritages is significantly below the level of the rent (nominal or peppercorn rent) which could reasonably have been obtained for the lands and heritages on the open market at the time the tenancy or other arrangement was entered into,
- payment of the rent for the lands and heritages is offset or cancelled, in whole or in part, by other transactions or arrangements, whether individually or as a whole,
- the arrangement has been identified in the tenancy or other arrangement as being for the purpose of mitigating rates liability,
- the occupier, or the person or body entering the tenancy or other arrangement, has no assets that are directly linked to the economic use being made of the lands and heritages.

B. Wound up within the first 12 months of Tenancy

One of the characteristics of avoidance in the non-domestic rates system is that the insolvency process is entered into very shortly after the signing of a new lease agreement. The criteria below establishes a standard, such that where a new occupier enters into insolvency within a particular period (12 months from the start of the lease) the owner can be treated as liable for non-domestic rates; providing that at least one of two further indicators connected to the reduction or remission of rates liability are also present.

The purpose of the indicators is to distinguish cases of genuine insolvency from those which may seek to use it as a means to mitigate the non-domestic rates liability on the property.

The circumstance and indicators are set out below:

- The liable occupier is a body being wound up voluntarily under the Insolvency Act 1986, within a period of 12 months from the date on which the property first became occupied under the lease agreement, where:
 - the property continues to be occupied, including by a person or body other than the body which has entered the tenancy or other arrangement, or
 - the liability holder is in receipt of mandatory non-domestic rates relief¹.

C. Characteristics and Behaviours of the Occupier

¹ A form of relief from liability to non-domestic rates under section 153 of the Local Government etc. (Scotland) Act 1994, or section 4(2) of the Local Government (Financial Provisions etc.) (Scotland) Act 1962

There are a number characteristics of the occupying party, or behaviours (and prior behaviours) which, when coupled with the presence of a non-domestic rates advantage, are strong indicators of avoidance, for instance, where the liable party in a tenancy, or other arrangement, has no named individual associated with the operation of a business or with connection to the property. In certain instances where the premises is let to a Special Purpose Vehicle (SPV) company, it can be difficult to identify any 'named' or natural person responsible for the liability, or responsible on behalf of the SPV holding the liability, and therefore challenging for the Local Authority trying to assign a rates bill.

It is not uncommon for a director to be an individual with no connection to the operation of the business in the property. Further, there are instances of those that have engaged in phoenix-ing or other artificial avoidance behaviours that have previously engaged in trading practices that are forbidden, fraudulent or wrongful.

In addition, a Local Authority may suspect manipulation or abuse in order to artificially meet the criteria to be eligible for a relief e.g. through charitable rates relief. In this case the owner of a property an artificially lease the premises to a charity in order for the premises to receive 80% mandatory relief, when in fact the premises are only part-occupied by the charity, or left vacant with little or no charitable activity actually taking place in the premises.

The characteristics and behaviours of the occupier that are contained in these regulations are set out below:

- the occupier fails to provide the name of a person who is liable for payment of the rates, or who is liable on behalf of the occupier (e.g. where a company is occupying),
- the person liable for payment of the rates, or liable on behalf of the occupier, is a person who has no connection to the operation taking place on the lands and heritages,
- the person liable for payment of the rates, or liable on behalf of the occupier, is a person who is an employee or a contractor of the owner of the lands and heritages, or who is the partner or a close relative of the owner,
- the person liable for payment of the rates, or liable on behalf of the occupier, has within the period of two years prior to the date on which the tenancy or other arrangement was entered:
 - carried out the business or exercised the borrowing powers of a public company which did not have a trading certificate, contrary to section 761(1) of the Companies Act 2006,
 - have been declared by a court to be liable to make a contribution to the assets of a company, in the course of its winding up, as a result of:
 - (i) knowingly having been a party to the carrying on of business in the manner described in section 213(1) of the Insolvency Act 1986 (fraudulent trading) or section 246ZA(1) of that Act (fraudulent trading: administration), or
 - (ii) being or having been a director to whom section 214(2) of that Act (wrongful trading) or section 246ZB (wrongful trading: administration) of that Act applies,

- have had a disqualification order made against them, or a disqualification undertaking accepted, under the Company Directors Disqualification Act 1986,
- have been convicted of a contravention of section 216 of the Insolvency Act 1986 (restriction on re-use of company names),
- have been subject to a bankruptcy restrictions order, or a bankruptcy restrictions undertaking, under the Bankruptcy (Scotland) Act 2016, the Insolvency Act 1986, or the Insolvency (Northern Ireland) Order 1989, or
- have been issued a notice under section 20 of the 2020 Act (non-use or underuse of lands and heritages: notification) in relation to which the local authority has, following the expiry of the period mentioned in section 20(5)(b) or receipt of an explanation from the ratepayer, concluded that either of the conditions in section 20(3) or (4) of that Act have been satisfied.

Requirement to Notify – Information Notice

Where a local authority intends to treat the owner of a property as liable to pay non-domestic rates, the local authority must inform the owner by sending a notice in writing.

The notice must:

- set out the intention to treat the owner as being liable to pay non-domestic rates,
- explain the basis on which the treatment is to happen,
- set out the dates from which the treatment may have effect, and explain that the relevant one will apply in any given case (depending on whether this is a repeat of previous avoidance), and
- advise that any relief from liability to non-domestic rates which was previously available will cease to be available, with effect from the relevant date.

Written Representations

Regulation 5 allows the treatment of the owner as liable to be avoided where the local authority is satisfied that the tenancy or other arrangement does not have as its main purpose the gaining of an artificial advantage – this requires to be demonstrated through submitting written representations.

An owner who receives a notice may:

- demonstrate that the tenancy or other arrangement under which the lands and heritages are occupied does not have as its main purpose the gaining of an advantage; or
- agree an alternative payment arrangement with the local authority.

Timeline for Owner Submission

Any written representations by the owner against an information notice issued under regulation 5 must be sent to the local authority:

- within the period of 28 days beginning with the date on which the notice of intention to treat the owner as liable is presumed to have been received (48 hours after it is sent); and

- may be sent by means of electronic communication.

Timeline for issuance of a Final Notice

The local authority must issue a Final Notice:

- within the period of 28 days beginning with the day on or before which representations must be submitted, and
- which sets out the reasons for the decision, regardless of whether or not the owner is to be treated as liable to pay the non-domestic rates.

Where the owner is to be treated as liable to pay the rates, the Final Notice must set out:

- the liability resulting from that, including a reference to any relief removed as a result; and
- the date from which the treatment and, where relevant, the removal of relief has effect.

Date from which the Owner is treated as Liable

Regulation 6 outlines that, where the owner is to be treated as liable for non-domestic rates, this may have effect from a date no earlier than 28 days after the date on which the notice of the intention to treat them as such is presumed to have been received.

It also sets out an exception to that position. Where identified practices have occurred and then occur again within the subsequent five years in relation to any lands and heritages in Scotland associated with the same owner, then the date from which liability on the owner takes effect can be the later of either:

- the start of the relevant tenancy agreement, or
- the date on which the owner first received a final notice.

The objective of this is for the transfer of liability to be able to have effect from the start of a tenancy, where there is a repeated avoidance practice in relation to the same owner of any lands and heritages in Scotland; however, that effect date cannot pre-date the first instance where the owner became liable.

Removal of relief and subsequent applications for relief

Regulation 7 sets out that any relief associated with the lands and heritages is to cease if and when the liability transfers, with effect from the date on which the transfer takes effect.

However, the regulation allows for a new application for relief to be made, providing that the applicant can demonstrate that the application is not for the purpose of obtaining an ‘artificial’ advantage. This may be achieved by demonstrating that there is no advantage, for example in establishing a payment arrangement with the Local Authority; or demonstrating to the satisfaction of the Local Authority that the enterprise is now legitimate because previously identified ‘artificial’ behaviour is no longer present.

The policy objective for the ceasing of relief (and allowing a new application to be accepted where appropriate), is because where the owner is treated as liable for non-domestic rates, they may still attempt to claim mandatory rates relief on the property, by virtue of there being a qualifying occupier. The policy intention behind allowing for a re-application of relief and

awarding, provided the Local Authority is satisfied there is no presence of an artificial arrangement, is to ensure that future occupiers of property that have not been the object of artificial avoidance arrangements, are not penalised.

Part 3 – Physical Changes to Premises Avoidance

Part 3 has the policy objective of empowering local authorities to counteract deliberate actions seeking to obviate in whole or in part the payment of rates on a property through a reduction of rateable value by making physical change to its state (i.e. property destruction).

The regulations enable local authorities, in certain circumstances and when certain conditions are met, to disregard for rating purposes a particular reduction in rateable value which results from a change to the property (i.e. the local authority can treat the property as if the change had not taken effect and levy rates based on the rateable value which applied prior to that change).

To ensure that these powers are applied only where the action is deemed artificial and for the purposes of avoidance and advantage, certain conditions must be met.

For a physical change to be disregarded, the following conditions must be met:

- prior to 1 April 2023 the property was either not charged rates, or charged lower rates, due to being unoccupied;
- the change was made and took effect after 1 April 2023 (this date corresponds to the devolution of empty property relief to local authorities);
- there is no evidence of an intention to use the lands and heritages for economic activity in the future. This recognises that genuine repair or redevelopment work can require changes to property which impact on beneficial occupation, but that such changes will have a clear purpose and plan. These regulations are intended to target avoidance practices, where there is no evidence that the property will be made suitable for occupation and put back into economic use; and
- the local authority is satisfied, in all the circumstances, that:
 - the change has been made for the sole reason of reducing the net annual value or rateable value of the lands and heritages, or
 - there is no clear link between the change that caused the reduction in net annual value or rateable value and an intention to make the lands and heritages the subject of economic activity.
- In their determination as to whether the latter condition has been met (clear link between the change that caused the reduction and the intention for economic activity), the Local Authority may have regard to comparable lands and heritages or comparable economic activity.

The policy objective of the comparative test (with lands and heritages or economic activity) is to distinguish between destruction for the purposes of rates liability mitigation, and the natural decline of a property, or an unexpected incident. Further, a comparative test will seek to ensure that a given change to construction works has not been undertaken with an intention

to avoid rates and are in fact part of a genuine redevelopment or renovation plans to put the property into commercial use.

Where a property destruction is intended, as part of a planned refurbishment, an inspection of the economic activity might reveal corroborative behaviours to support the claim that the change is not for an advantage (e.g. renovation plan and/or legitimate marketing activity to demonstrate that the owner of the property is seeking to make it economically active). A comparative test may also include looking at similar property uses and redevelopments, to ensure that a property change corresponds with the planned economic activity.

Advising of disregarding of change

Regulation 9 sets out the steps the local authority must take before any physical change is disregarded, meaning that for rating purposes, the rates are levied on the property at the rateable value which applied before the change was made.

The local authority must notify the owner or occupier of its intention to counteract the change to the property for the purposes of non-domestic rates liability, and levy rates based on the previous rateable value. In addition to the intended change, the notification must explain the reason for it.

The owner or occupier has 28 days to make representation to demonstrate that the change was not intended to gain an artificial advantage, for example, if it can be evidenced that the work was carried out as part of a genuine redevelopment to bring the property back into economic use.

The local authority must issue a final notice setting out the final decision on whether the liability should be adjusted to reflect the change, reasons for it and any change in rates liability arising as a result. This notice must be issued within a 28-day period from the last day on which representations can be submitted. Where a change is being disregarded, the liability will be based on the rateable which applied the day before it was revised.

Consultation

A closed consultation (see Annex A) was carried out from 19 October to 2 December 2022. The consultation paper invited views on the draft regulations.

In accordance with the 2020 Act, the consultation exercise sought views from certain Local Authority revenue managers (including through the Institute of Revenue Rating and Valuation), the Scottish Assessors Association, as well as a small number of other bodies that it was considered appropriate to consult, including various professional and practitioner bodies.

On 14 November 2022, the Minister for Public Finance, Planning and Community Wealth wrote to the Convener to the Local Government, Housing and Planning Committee to inform the Scottish Parliament of the consultation exercise.

Impact Assessments

No Business and Regulatory Impact Assessment is required.

There is limited data on avoidance practices, beyond the individual case examples shared by Local Authorities. These regulations seek to address those rare circumstances of avoidance, and as such will not impact the collection of non-domestic rates in the overwhelming majority of cases.

Financial Implications

Given the absence of data, the Scottish Fiscal Commission has at this point not deemed the laying of these regulations to be material to the non-domestic rates income forecast.

There may be costs to local authorities associated with the administration of action taken under the regulations, which would require to be absorbed as part of the normal process of collecting and administering rates.

Scottish Government

Local Government and Communities Directorate

Annex A – Summary Statement on Consultation Exercise

The following is a statement summarising the representations received through the consultation and highlighting which policy changes were made to the draft Regulations as a result of those representations.

The consultation ran from 19 October to 2 December 2022 and invited views on draft regulations to be made under Part 4 of the 2020 Act to empower local authorities to tackle known avoidance tactics, in Scotland only.

On 14 November 2022, the Minister for Public Finance, Planning and Community Wealth wrote to the Convener to the Local Government, Housing and Planning Committee to inform the Scottish Parliament of the consultation exercise.

Given the nature of these Regulations, and the risk of unintended behavioural responses that public dissemination could have posed, the consultation was ‘closed’ (i.e. by invitation only).

Under the 2020 Act, the Scottish Ministers are obliged, before laying a draft of the regulations before the Scottish Parliament, to consult such persons as appear to them to represent the interests of local authorities or assessors as the Scottish Ministers consider appropriate. In accordance with that obligation, the consultation exercise sought views from certain Local Authority revenue managers (including through the Institute of Revenue Rating and Valuation), the Scottish Assessors Association, as well others considered appropriate including from various professional and practitioner bodies. All responses were taken into account before the draft regulations were laid before the Scottish Parliament.

Generally, respondents did not have any strong objection to the policy intent of the instrument, or what the regulations sought to achieve.

On the basis of certain comments, some changes were made to the draft Regulations. These mostly related to the indicators pertaining to the characteristics and behaviours of the person named by the occupier as liable for payment of rates (regulation 4(5)), and the provisions regarding the treatment of owners as liable for non-domestic rates (regulations 4 to 7 generally). Changes include:

- The regulations now refer to sections 246ZA and 246ZB of the Insolvency Act 1986, as well as referring to sections 213 and 214 of the Insolvency Act 1986, and in doing so now also capture occupiers found to have been engaging in fraudulent or wrongful trading in the context of administration.
- The regulations no longer refer only to section 1 of the Company Directors Disqualification Act 1986 (CDDA), reflecting that disqualification orders can be sought under numerous sections of the Act.
- The regulations now, with reference to the CDDA, also include disqualification ‘undertakings’; this is how most directors are disqualified, and has the same effect as a court order, but involves voluntary disqualification and avoids court action.
- Bankruptcy Restriction Orders and undertakings were also added as indicators - this involves where an individual is made bankrupt, they will usually be discharged from bankruptcy after one year - if behaviour during that time is considered dishonest, you could be reported to the Accountant in Bankruptcy (AiB). Where this happens, AiB may apply to the sheriff for a bankruptcy restriction order against the person.

Further changes have been made to the regulations based on follow-up communication with respondents. This included an addition to the circumstances in which a local authority may conclude that a tenancy or other arrangement is not on a 'commercial basis' (Regulation 4(6)), where it was highlighted that the draft regulations did not cover all situations of offsetting of the rent charged (for example through wider arrangements). As such, the regulations now include circumstances where, "payment of the rent for the lands and heritages is offset or cancelled, in whole or in part, by other transactions or arrangements, whether individually or as a whole."

With regard to Part 3 (disregarding of changes leading to reduction in rateable value), which concerns avoidance through physical changes to premises, conversations with respondents highlighted the need to include a comparative test (with lands and heritages or economic activity) in relation to assessing the link between the change and an intention to make the property economically active. The comparative test now included in the regulations seeks to ensure that building work changes are genuine, and with reference in particular to comparative economic activity, enables local authorities to consider, relative to similar projects, any corroborative behaviours that support the claim that a property change corresponds with the planned economic activity, rather than being for the avoidance of non-domestic rates.

In addition to these substantive changes made as a result of feedback from stakeholders, further minor drafting changes have been made to the regulations since the end of the consultation period to refine them and ensure their effective operation.