# EXPLANATORY MEMORANDUM TO

# THE SCOTTISH RATE OF INCOME TAX (CONSEQUENTIAL AMENDMENTS) ORDER 2015

## 2015 No. 1810

**1.** This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

**2. Purpose of the instrument**

2.1 The Scottish rate of income tax (SRIT) introduced in the Scotland Act 2012 (c. 11) is used to calculate the Scottish basic rate, higher rate and additional rate which are expected to apply to the non-savings income of a Scottish taxpayer from April 2016. These provisions have implications for other areas of the Income Tax system. This instrument makes consequential amendments to ensure certain Income Tax rules which currently refer to the basic, higher and additional rates operate as intended with the introduction of SRIT.

**3. Matters of special interest to the Select Committee on Statutory Instruments**

3.1 The Order is the first use of the powers in section 80G(1A) and (2) of the Scotland Act 1998 (c. 46) as inserted by section 25 of the Scotland Act 2012 and amended by paragraph 16 of Schedule 38 of the Finance Act 2014 (c. 26).

**4. Legislative Context**

4.1 The Order amends a number of areas of the Income Tax Acts and linked Regulations to deal with consequential changes needed to allow for the potential differences between the Scottish basic, higher and additional rates and the basic, higher and additional rates. These include provisions on relief at source on pension contributions and Gift Aid relief.

4.2 These amendments will work alongside others amendments consequential on the introduction of SRIT which were made in Part 2 of Schedule 38 of the Finance Act 2014 and which are planned in regulations amending the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682).

4.3 In the course of Parliamentary consideration of what is now section 80G of the Scotland Act 1998 [House of Commons Hansard Debates for 14 Mar 2011 (pt 0003)] the Government committed HMRC to work closely with all parties concerned, including the Scottish Government on the manner in which sought to use this power.The Government also committed publish draft legislation in advance, giving all parties an opportunity to comment. HMRC confirms that this instrument has been prepared in that manner.

## 5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

## 6. European Convention on Human Rights

The Financial Secretary to the Treasury, David Gauke, makes the following statement regarding Human Rights:

"In my view the provisions of the Scottish Rate of Income Tax (Consequential Amendments) Order 2015 are compatible with the Convention rights".

## 7. Policy background

- ***What is being done and why***

7.1 The Scotland Act 2012 introduced the Scottish rate of Income Tax (SRIT), to be implemented in April 2016. The Scottish rate of income tax will apply only to income from earnings, pensions and other non-savings sources.

7.2 The Scottish basic rate, higher rate and additional rate paid by Scottish taxpayers will be calculated by reducing the UK basic, higher and additional rates of Income Tax by 10 pence in the pound and adding the Scottish rate income tax set by the Scottish Parliament.

7.3 These amendments make the necessary consequential changes to reflect the Scottish rate of income tax, setting out how aspects of Income Tax will operate where an individual is a Scottish taxpayer.

Pensions Relief at source

7.4 The current system for giving relief at source will not automatically provide the correct relief for Scottish taxpayers under SRIT.

7.5 This instrument amends the rules covering relief at source on pension contributions to ensure that relief at source will be paid at Scottish rates for Scottish taxpayers, meaning that, as far as possible, Scottish taxpayers receive the correct amount of relief into their pension pot.

7.6 The Government has acknowledged that the pensions industry is working in a challenging environment at present and therefore has agreed that they can have longer to implement these changes. Currently it is planned that from April 2018 industry should be ready to make RAS claims at the Scottish basic rate. In the meantime, to ensure that pension scheme members who are Scottish taxpayers aren't disadvantaged, the Government has agreed that from April 2016 pension scheme administrators can continue to claim RAS at the UK basic rate of tax for all members and HMRC will identify Scottish taxpayers and make any adjustment (depending on the rate set by the Scottish Government), to the relief given direct with the scheme member. This will be done either through the Self Assessment process or PAYE coding.

Special tax charges

7.7 Chapter 5 of Part 4 of FA 2004 contains a number of special tax charges. The majority of these are designed to generate a charge which is based broadly on current rates, so actual percentages are used in the legislation. In two areas though there are specific references to rates.

7.8 This instrument amends section 227 (the annual allowance charge) and section 237B (‘scheme pays’ rules) to ensure these provisions operate appropriately under SRIT. To do so references within those sections to “basic rate”, “higher rate” and “additional rate” are supplemented by the insertion of references to the Scottish equivalents which will apply Scottish taxpayers.

Deficiencies Relief

7.9 Deficiency relief may be available to individuals when their life insurance policy, life annuity contract or capital redemption policy comes to an end. Individuals may be entitled to the relief if the tax calculation needed when a policy or contract comes to an end gives a negative result rather than a gain, but taxable gains have arisen earlier in the life of the same policy or contract.

7.10 The amount of the deficiency relief tax reduction is determined using the amount of any deficiency to reduce the amount of income liable at the highest rate and then in sequence at each lower rate. This instrument amends section 539 of the Income Tax (Trading and Other Income) Act 2005 to include income liable at various Scottish main rates in this sequence, factoring in the possibility that Scottish higher rate could be higher or lower than the UK higher rate.

Social Security Pensions Lump Sum

7.11 Section 7 of Finance (No 2) Act 2005 provides the tax treatment for social security pension lump sums. This sets out that the rate of tax paid by an individual on their lump sum should be the same as their highest marginal rate, determined by reference to their total income as established in the wider calculation of income tax liabilities.

7.12 This instrument amends Section 7 of Finance (No 2) Act 2005 to ensure lump sums will be taxed at the Scottish rates for Scottish taxpayers by augmenting references to "basic rate", "higher rate" and "additional rate" with references to the Scottish equivalent rates if the individual is a Scottish taxpayer.

Amendments to the Income Tax Act 2007 (ITA)

7.13 This instrument also augments references to rates of income tax, with the insertion of reference to equivalent rates for Scottish taxpayers, in those parts of ITA covering the calculation of total income, entitlement to transferable tax allowance for married couple and civil partners, election to reduce personal allowance and relief for gifts to charity.

- **Consolidation**

7.14 Not applicable.

**8. Consultation outcome**

8.1 In accordance with the Government's Tax Consultation Framework, on 19 December 2014, a draft of this instrument accompanied by a Technical Note "Clarifying the Scope of the Scottish Rate of Income Tax" was published on the Gov.UK website for comment.

8.2 This Technical note provided an update to an earlier Technical Note, published in May 2012 which set out the Government's policy intentions in areas where the rate setting power of the Scotland Act 2012 interacts with other areas of the income tax system.

8.3 No substantive comments were received following publication of the instrument and Technical Note.

**9. Guidance**

9.1 Guidance covering all those areas amended by this instrument will be updated prior to the commencement of SRIT to reflect these changes.

**10. Impact**

10.1 A Tax Information and Impact Note covering the legislative changes from the Introduction of the Scottish Rate of Income Tax was published in March 2014 and is available at http://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins.

It remains an accurate summary of the impacts that apply to this instrument.

## 11. Regulating small business

This instrument enables the implementation of a previously announced policy, the changes it makes are expected to have no impact on small business.

## 12. Monitoring & review

12.1 The legislation contained within this instrument will be monitored and reviewed as appropriate within the context of the wider legislative scheme on SRIT.

## 13. Contact

Simon Moulden at HMRC tel. 03000 585 448 or email: simon.moulden@hmrc.gsi.gov.uk can answer any queries regarding the instrument: