**EXPLANATORY MEMORANDUM TO**

**THE SCOTTISH RATES OF INCOME TAX (CONSEQUENTIAL AMENDMENTS) ORDER 2021**

**2021 No. 190**

## 1. Introduction

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

## 2. Purpose of the instrument

2.1 This instrument makes a consequential amendment to the social security pension lump sum legislation in respect of Scottish taxpayers to ensure that they like taxpayers in the rest of the United Kingdom, pay income tax on the pension lump sum at the highest rate that they pay income tax in the year in which the lump sum is received.

## 3. Matters of special interest to Parliament

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

3.1 None.

***Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)***

3.2 The territorial application of this instrument includes Scotland and Northern Ireland.

3.3 The powers under which this instrument is made cover the entire United Kingdom (see section 131 of the Scotland Act 1998) and the territorial application of this instrument is not limited either by the Act or by the instrument.

## 4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

## 5. European Convention on Human Rights

5.1 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, has made the following statement regarding Human Rights:

"In my view the provisions of the Scottish Rates of Income Tax (Consequential Amendments) Order 2021 are compatible with the Convention rights."

## 6. Legislative Context

6.1 Section 7(5A) of the Finance (No. 2) Act 2005 provides for social security pension lump sums to be taxed at the highest income tax rate applicable to an individual's "Step 3 income"(defined in section 7(9) of that Act) in the tax year of receipt. A social security pension lump sum is a one-off payment, in respect of and equal to the amount foregone during the period of deferral, made to recipients (who reached state pension age before 6 April 2016) who defer receipt of their social security pension.

6.2 The Scotland Act 2016 devolved further Scottish income tax powers to the Scottish Parliament, building on its existing power to set a Scottish rate of income tax. The further powers commenced for the 2017-18 tax year and require a Scottish basic rate of income tax to be set for each tax year and enable, in addition, other rates and thresholds for income tax to be set, which could vary in amount and name from those set by the United Kingdom Parliament. These powers relate to non-savings, non-dividend income tax only.

6.3 In 2017, changes were made to the pension lump sum legislation in section 7(5A) of the Finance (No. 2) Act 2005 by the Scotland Act 2016 (Income Tax Consequential Amendments) Regulations 2017 (S.I. 2017/468) to take account of the Scottish Rates of income tax.

6.4 The Scottish Parliament introduced additional income tax rate bands for the 2017-18 tax year. Legislation was further amended by the Scottish Rates of Income Tax (Consequential Amendments) Order 2018 (S.I. 2018/459), to take account of the introduction of new Scottish rates and bands of income tax, including that Scottish taxpayers who receive a social security pension lump sum can be taxed at the new Scottish starter rate where appropriate.

## 7. Policy background

***What is being done and why?***

7.1 The changes to section 7(5A) of the Finance (No. 2) Act 2005 in 2018 referred to the highest Scottish rate that a Scottish taxpayer is liable to. This could be interpreted as not taking account of any savings or dividend income of Scottish taxpayers, as tax on those forms of income is not devolved.

7.2 Tax has not been charged in line with this possible interpretation. Instead, HMRC are satisfied that section 7(5A)(c) currently permits tax to be charged as intended, which is to charge the social security pension lump sum at the highest Scottish income tax rate which would apply to the whole of a person's income (including dividend and savings income). This practice is not changing. But the legislation could be clearer.

7.3 This instrument therefore amends section 7(5A)(c) of that Act to ensure that it is clear that Scottish taxpayers (like taxpayers in the rest of the United Kingdom) pay income tax on the pension lump sum at the highest Scottish rate that would apply to an amount of income which includes their savings and dividend income, in the year the lump sum is received.

## 8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

## 9. Consolidation

9.1 The legislation is not being consolidated.

## 10. Consultation outcome

10.1 These amendments were not subject to consultation because they amend legislation in order to ensure that it operates as intended.

## 11. Guidance

11.1 Guidance will updated in the Employment Income Manual here: https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim74652 and https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim74651, as soon as possible after the instrument is laid.

## 12. Impact

12.1 There is no significant impact on business, charities or voluntary bodies.

12.2 There is no significant impact on the public sector.

12.3 A Tax Information and Impact Note has not been prepared for this instrument as it contains no substantive changes to tax policy.

## 13. Regulating small business.

13.1 The legislation does not apply to activities that are undertaken by small businesses.

## 14. Monitoring & review

14.1 The legislation contained within this instrument will be monitored and reviewed as appropriate within the context of the wider legislative scheme on Scottish income tax powers.

14.2 This regulation does not include a statutory review clause because of a tax exemption in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

## 15. Contact

15.1 Marilyn Stephenson at HM Revenue and Customs Telephone: 03000 594713 or email: marilyn.stephenson@hmrc.gov.uk can be contacted with any queries regarding the instrument.

15.2 Jackie McGeehan, Deputy Director for the Individuals Policy Directorate, at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.