These notes refer to the Finance Act 2014 (c.26) which received Royal Assent on 17 July 2014

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 296 and Schedule 38: Scottish Basic, Higher and Additional Rates of Income Tax

Summary

1. This section introduces Schedule 38 which amends the structure of the income tax legislation setting out how the Scottish rate of income tax is applied in calculating the overall rates of tax applicable to the non-savings income of Scottish taxpayers and makes other consequential changes.

Details of the Schedule

Part 1

2. Paragraph 2 sets out that subsections (2A) to (2C) of section 6 of the Income Tax Act 2007 (ITA) will be omitted. This removes the rates of income tax applied to the non-savings income of a Scottish taxpayer that were inserted by the Scotland Act 2012 and inserts a new subsection (2)(za) which signposts the Scottish, basic, higher and additional rates.

3. Paragraph 3 inserts new section 6A(1) setting out the calculation to determine the Scottish basic, higher and additional rates of income tax. The UK basic, higher and additional rates will be reduced by 10 percentage points and the Scottish rate, set by the Scottish Parliament, added across the (reduced) rates. (This is exactly the same calculation method as was inserted by the Scotland Act 2012.) So a Scottish rate of 10 per cent would mean the rates paid by Scottish taxpayers were the same as elsewhere in the UK, a rate of 9 per cent would mean the rates were slightly lower and a rate of 11 per cent would mean they were slightly higher. Section 6A(2) points to Chapter 2 of Part 4A of the Scotland Act 1998, which describes how the Scottish rate is set.

4. Paragraph 4 inserts an entry for new section 11A in section 10 of ITA, which signposts provisions that apply different rates of tax to certain types of income.

5. Paragraph 5 inserts new section 11A into ITA which sets out income liable to the Scottish basic, higher and additional rates of income tax.

6. New section 11A(1)-(3) sets out that the Scottish basic, higher and additional rates apply to "non-savings income" that would otherwise be chargeable at the main basic, higher and additional rates if the individual were not a Scottish taxpayer.

7. New section 11A(4) defines "non-savings income" for the purposes of this section. The effect is that the Scottish basic, higher and additional rates do not apply to savings income as defined in section 18.

8. New section 11A(5) and (6) makes new section 6A subject to section 13 of ITA and other cases where income may be charged at a different rate.

9. Paragraph 6 amends section 13 of ITA, which applies the dividend rates to dividend income. The effect is that dividend income continues to be charged at the dividend ordinary, upper and additional rates rather than the Scottish rates.

10. Paragraph 7 confirms that section 16 of ITA has effect for determining which rate applies to a Scottish taxpayer's non-savings income. Section 16 provides the ordering rules for income tax rates. In essence section 16 determines that income that is not savings or dividends is the first slice of taxable income; savings income is the second slice; dividend income is the third slice. The effect of paragraph 7 is that a Scottish taxpayer's non-savings income will be subject to the Scottish rates first; their savings income will then be subject to the appropriate UK main rate(s) and then their dividend income will be subject to the appropriate UK dividend rate(s).

11. Paragraph 8 amends section 809H of ITA to exclude the Scottish rates of income tax in calculating the charge on non-UK residents for using the remittance basis.

12. Paragraph 9 amends section 828B of ITA. Sections 828A-828D of ITA provide for an income tax exemption for low income employees working in the UK who are resident (but not domiciled) in the UK and meet certain conditions (set out in section 828B). Such individuals will typically be migrant workers employed in seasonal work in the agricultural or service sectors in the UK and in other countries in the same tax year and whose overseas income is subject to tax where it is earned. This amendment ensures that any such individuals who are Scottish taxpayers will continue to benefit from that exemption

13. Paragraphs 10 and 11 amend section 989 of and Schedule 4 to ITA to include the definitions of the Scottish basic, higher and additional rates of income tax as separate entries. This means that, unless otherwise provided for, references to the basic, higher and additional rates mean the UK main rates in section 6 of ITA. The paragraphs also clarify that the definition of a Scottish taxpayer is the one set out in the Scotland Act 1998.

14. Paragraph 12 sets out the commencement of these amended provisions – they will be introduced alongside the rest of the Scottish rate of income tax provisions, which are expected to be implemented in April 2016.

Part 2

15. Paragraph 13 removes the amendment to section 1 of the Provisional Collection of Taxes Act 1968 made by section 26 of the Scotland Act 2012, as this is no longer required under the restructured Scottish rate provisions.

16. Paragraph 14 amends section 7 of the Taxes Management Act 1970 (TMA). This section imposes requirements on individuals to notify HMRC if they are chargeable to income tax in a year. Section 7(6) of TMA includes an exemption from the requirement to notify for individuals whose income has either had (or been treated as having) income tax paid on it or who have received dividend income, and who are not "liable to tax at a rate other than the basic rate, the dividend ordinary rate or the starting rate for savings" for that year. The amendment made by paragraph 14 ensures Scottish taxpayers will continue to benefit from this exemption.

17. Paragraph 15 amends the Taxation of Chargeable Gains Tax 1992 (TCGA). Section 4 of TCGA sets out the rate of Capital Gains Tax (CGT) that an individual pays – this can be affected by the rate of income tax at which an individual is liable. Sub-paragraphs (2) and (3) therefore make amendments to sections 4 and 4A of TCGA to ensure that Scottish taxpayers continue to pay CGT at the appropriate rate.

18. The amendments made by paragraphs 14 and 15 will have effect at the same time as the rest of the Scottish rate provisions are introduced (expected to be April 2016).

19. Paragraph 16 sets out amendments to the Scotland Act 1998. Sub-paragraph (2) amends the cross reference in section 80C (which determines the rules for making a Scottish rate resolution) so that it refers to sections 6A and 11A of ITA (inserted by this Schedule), rather than the repealed section 6(2B) of ITA. Sub-paragraphs (3)-(7) change the power to make further amendments in section 80G. This is to update the power to reflect the insertion of new section 11A of ITA, ensure that the power works as intended (including addressing the consequences for the operation of the PAYE system if no Scottish rate is passed) and limit the scope of the power to more specific types of amendment. Sub-paragraph (8) amends section 110 to ensure that the power here for the Department for Work and Pensions to make regulations concerning Scottish taxpayers will continue to work as intended (these amendments are to be commenced by order by the Secretary of State). Sub-paragraphs (9)-(11) make other consequential amendments, including providing for (at sub-paragraphs (10)(a) and (11)) the repeal of section 79 (the equivalent of section 80G under the Scottish variable rate provisions). Sub-paragraph (13) gives the Treasury the power to determine the timing of the repeal of section 79 by order

20. Paragraph 17 repeals section 26 of the Scotland Act 2012, which has been replaced by the provisions in the Schedule.

Background Note

21. The Scotland Act 2012 legislates for the Scottish rate of income tax, which is expected to be introduced in April 2016. The annual basic, higher and additional rates of income tax set by the UK Government will be reduced by 10 pence in the pound for Scottish taxpayers. Annually the Scottish Parliament will levy a new Scottish rate of income tax which will apply equally to all of the reduced main UK income tax rates. The application of the Scottish rate is achieved by amendments to ITA which determines the rate of tax paid by Scottish taxpayers on their non-savings income and dividends.

22. The Scottish rate has implications for particular aspects of the income tax system, for example Gift Aid and pensions tax relief. HMRC consulted external organisations to agree a suitable way forward and published a Technical Note in May 2012 setting out how it intended to manage these issues. The Schedule makes amendments to the Scottish rate provisions in ITA so that the wider consequential changes can be made in a more straightforward manner by secondary legislation.