EXPLANATORY MEMORANDUM TO

THE SCOTTISH RATES OF INCOME TAX (CONSEQUENTIAL AMENDMENTS) ORDER 2018

2018 No. [XXXX]

1. Introduction

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

2. Purpose of the instrument

2.1 Under Scottish income tax powers set out in the Scotland Act 2016 (c. 11), the Scottish Parliament has introduced two new income tax rates for the 2018-2019 tax year: the Starter rate and the Intermediate rate. This instrument makes consequential amendments to tax legislation to ensure that, following the introduction of the new rates, tax reliefs and other relevant legislation will continue to apply to Scottish taxpayers as they are intended to.

2.2 In particular, the instrument amends the legislation for Gift Aid, the Marriage Allowance and pensions tax relief. The amendments do not change how these reliefs operate, they simply allow them to work with the new Scottish rates of income tax.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland and is not a financial instrument that relates exclusively to England, Wales and Northern Ireland.

4. Legislative Context

4.1 These Regulations amend a number of areas of tax legislation to deal with consequential changes needed following the introduction of the new Starter and Intermediate rates of income tax which are applicable to non-savings and non-dividend income of Scottish taxpayers for the 2018-2019 tax year.

4.2 Further consequential amendments are being made to the Income Tax (Pay As You Earn) Regulations (S.I 2003/2682) which will come into force for the 2018-19 tax year. These amendments will ensure that the PAYE system operates as intended once the new rates have been introduced.

5. Extent and Territorial Application

5.1 This extent of this instrument is the United Kingdom.

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

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, Mel Stride, has made the following statement regarding Human Rights:

"In my view the provisions of the Income Tax (Scottish Rates Consequential Amendments) Regulations 2018 are compatible with the Convention rights."

7. Policy background

What is being done and why

7.1 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 UK Parliament.

7.2 On 20 February 2018 the Scottish Parliament passed a Scottish Rate Resolution setting the rates and thresholds applicable to Scottish taxpayers for the 2018-2019 tax year. This instrument makes consequential amendments to aspects of tax legislation to ensure that they continue to operate correctly following the introduction of these rates and thresholds.

Gift Aid

7.3 Section 414 of the Income Tax Act 2007 (c. 3) (ITA 2007) makes provision for tax relief to be given to UK taxpayers who make donations to charity under the Gift Aid scheme. Section 415 ITA 2007 provides further definitions that apply to the relief. Both sections refer to Scottish rates of income tax and are amended to make sure that the relief is given at the correct rate, following the introduction of the new Starter rate.

Pensions Relief at Source

7.4 Section 192 of the Finance Act 2004 (c. 12) (FA 2004) is amended to ensure that Scottish taxpayers who pay income tax at a Scottish rate higher than the Scottish basic rate will (on the making of a claim) be entitled to have their Scottish basic rate limit and any other Scottish rate limit above the Scottish basic rate limit increased by the amount of the grossed up contribution.

Marriage Allowance

7.5 Section 55B(2)(b) ITA 2007 sets out the tax rates at which an individual must be liable to tax in order to be eligible to a tax reduction for marriage allowance. Section 55C(1)(c) contains the tax rates at which an individual must be liable to tax in order to make an election to transfer marriage allowance. These sections are amended to include a Scottish rate of income tax below the Scottish basic rate and the new Intermediate rate.

Residuary Income of a Deceased Individual's Estate

7.6 Section 669 of the Income Tax (Trading and Other Income) Act 2005 (c. 5) provides for a reduction in the residuary income of a deceased's estate in certain circumstances. This section is amended to reflect the new Intermediate rate of income tax introduced by the Scottish Parliament.

Social Security Pension Lump Sum

7.7 Section 7(5A) of the Finance Act (No. 2) 2005 (c. 22) provides for social security pension lump sums to be taxed at the marginal tax rate applicable to an individual's "Step 3 income" (defined in s7(9) of that Act). This section is amended to make sure that this marginal rate may include the new Scottish rates.

Transfer of Assets Abroad

7.8 Section 745 ITA 2007 sets out the income tax rates applicable to the charges under section 720 or 727 of that Act, which arise for the purpose of preventing the avoidance of income tax by UK resident individuals by means of relevant transfers. This is amended to provide that income tax is not charged under these sections at a Scottish rate that is above 0% and below or equal to the main UK basic rate (which therefore includes the new Starter rate), to the extent that the income referred to in section 720 or 727 has already borne tax at the main UK basic rate of income tax.

7.9 Section 745(1) refers to "the starting rate for savings when that rate is more than 0%". New section 745(1A) refers to "a Scottish rate above 0% and below, or equal to, the basic rate".

7.10 The drafting in section 745(1) reflects the fact that the starting rate for savings is a single rate of income tax that is known to exist. This rate is currently 0% but until April 2015 was 10%. Current policy is that the rule in section 745(1) is to apply to the starting rate for savings only when that rate is above 0%. The existing wording in section 745(1) achieves this outcome.

7.11 Section 745(1A) is drafted slightly differently. This is because, although it is known what Scottish rates will exist for the tax year 2018-19 (and their level relative to the main UK basic rate of income tax for that year), neither of these facts are known for future tax years. For future tax years, the only certainty is that there will be a Scottish basic rate, since this is the only Scottish rate of income tax that is required to be set by law. It is possible that there will no Scottish rate, one Scottish rate or multiple Scottish rates of income tax other than the Scottish basic rate, which may in turn be less than, equal to, or more than the main UK basic rate of income tax. The Scotland Act 1998 (c. 46) also expressly allows for the possibility of setting a 0% Scottish rate. Current policy is that the rule in section 745(1A) is not to apply to a 0% Scottish rate if this exists in future, but that it is to apply to any other Scottish rate, or rates, that may be introduced if these are less than or equal to the main UK basic rate. The drafting in section 745(1A) achieves these outcomes.

7.12 Different ways of drafting the opening words of new section 745(1A) to achieve this outcome could have been used. The proposed use of the words "above" and "below" is consistent with other legislative references to Scottish rates, even if it does not exactly mirror the phrase "when that rate is more than" used in section 745(1) (which is quite possibly unique). It is considered that it would have been unnatural to use a similar formulation in section 745(1A) to that which is used in section 745(1) (i.e. "income tax at a Scottish rate when that rate is more than 0% and less than, or equal to, the basic rate"). This is because a reference to "a Scottish rate when that rate" may (in different tax years) catch no rates, one rate or, as in the 2018-19 tax year, more than one rate of income tax. It is therefore considered that the formulation used in section 745(1A) is more apt for the purposes of that provision, than that used in the circumstances of section 745(1).

Requirement to Notify Chargeability to Income Tax

7.13 Section 7 of the Taxes Management Act 1970 (c. 9) specifies the situations in which a person is not required to notify chargeability to income tax. This instrument amends that section so that the conditions operate by reference to the new Scottish rates. Additionally section 91(3)(c), which makes provision for the effect of relief, is amended to take into account the new Scottish rates.

Definitions

7.14 Section 989 ITA 2007 defines various terms for the purposes of the Income Tax Acts. This section is amended to insert a definition of the new Intermediate rate.

7.15 Although there will only be one Intermediate rate for the 2018-19 tax year, it is acknowledged that this definition could theoretically cover any Scottish rate with the word "intermediate" in its title. In the event that the Scottish Parliament voted for another category of "intermediate" rate, the Government would review legislative references to the "Scottish intermediate rate" to ensure that they continued to work correctly.

Consolidation

7.16 As this instrument amends primary legislation, there is no consolidation required.

8. Consultation outcome

8.1 These amendments were not subject to consultation because they only amend legislation in order to ensure that it continues to operate as currently intended.

9. Guidance

9.1 Guidance covering all those areas amended by this instrument will be updated prior to the start of the 2018-2019 tax year to reflect these changes.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is negligible.

10.3 An Impact Assessment covering this instrument was published on 28 May 2015 alongside the draft clauses and explanatory notes for the Scotland Bill and is available on the website at http://www.parliament.uk/documents/impact-assessments/IA15-004.pdf. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to activities that are undertaken by small businesses but are expected to have no impact upon them.

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 Scottish income tax powers.

13. Contact

13.1 Katharine Pottinger at HMRC Telephone: 03000 586205 or email: katharine.pottinger@hmrc.gsi.gov.uk can answer any queries regarding the instrument.