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United Kingdom – Devolution of Income Tax Powers to Scotland, Wales

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The Scottish Parliament's current powers to vary the basic rate of income tax paid by 'Scottish Taxpayers' will be extended from 6 April 2016.[1]

It is expected that legislation will be introduced to the U.K. Parliament later this year to further extend these powers (i.e., in addition to the changes which will become effective from 6 April 2016), though the timing of these additional prospective changes has yet to be announced.

Subject to the outcome of a referendum to be held in Wales, income tax varying powers in relation to 'Welsh Taxpayers' may also be devolved to the National Assembly for Wales (NAW).

Why This Matters

Employers should consider the potential implications for secondments to and from the U.K. if the income tax rates to be paid by 'Scottish Taxpayers' from 6 April 2016, on employment income diverge from those that apply to other U.K. taxpayers.

Similar considerations may in the future apply in relation to Welsh Taxpayers should income tax varying powers be devolved to the NAW.

Background

The Scottish Parliament is currently able to increase or decrease the basic rate of income tax paid by Scottish Taxpayers on income (other than interest and dividends) by up to three percentage points.[2] This power has not been used to date.

With effect from 6 April 2016, the Scotland Act 2012[3] provides that each of the main rates of income tax to be paid on the non-savings and non-dividend income of 'Scottish Taxpayers' must be calculated by reference to a single Scottish Rate of Income Tax (SRIT) set by resolution of the Scottish Parliament.[4]

Interest and dividend income received by Scottish Taxpayers will remain subject to income tax at the same rates that apply to other U.K. resident individuals.

The U.K. government published draft clauses for a Scotland Bill to be introduced after the U.K. general election in May 2015[5] which, if enacted, will allow the Scottish Parliament to vary without restriction the rates of income tax paid by Scottish Taxpayers on relevant income and allow the Scottish Parliament to vary the bands of income to which the different main rates of income tax apply.

The Wales Act 2014,[6] which received Royal Assent on 17 December 2014, provides that – subject to the outcome of a referendum to be held in Wales – income tax varying powers may also be devolved to the NAW in relation to Welsh Taxpayers.

Identifying Scottish Taxpayers

In summary, a Scottish Taxpayer is an individual who in a particular U.K. tax year:

- is U.K. resident for income tax purposes; and
- either:
  - has a 'close connection' with Scotland; or
  - cannot establish a close connection with any constituent part of the U.K. (i.e., either England, Northern Ireland, Wales, or Scotland) but spends at least as many days in Scotland as in the rest of the U.K. (i.e., England, Wales, and Northern Ireland) combined.

Broadly, an individual will have a close connection with a constituent part of the U.K. in a particular tax year if his or her sole place of residence in the U.K. is located there.

Where an individual has more than one place of residence in the U.K. during a tax year, he or she will have a close connection with part of the U.K. if his or her main U.K. residence has been located there for at least as long as it has been located in any one other part of the United Kingdom.

KPMG Note

An individual is a Scottish Taxpayer, and therefore subject to the Scottish main rates of income tax on relevant income, for the whole of a particular U.K. tax year. You cannot be, for example, a Scottish Taxpayer for the first part of the U.K tax year and an 'English' taxpayer for the remainder of the year.

However, as Scottish Taxpayer status determines only the rates at which U.K. income tax is paid on relevant income, and does not equate to a new concept of Scottish tax residence, internationally mobile individuals who are Scottish Taxpayers for a particular tax year would not be chargeable on non-U.K. source income that arises before they are taxed as a U.K. resident, or after they stop being taxed as such on a 'split year' basis.

Non-U.K. resident individuals with chargeable U.K. work-days that are spent in Scotland will not be Scottish Taxpayers and will therefore be subject to income tax on associated employment income at the U.K. main rates, rather than the Scottish main rates.

The U.K. tax authority, HM Revenue & Customs (HMRC), has stated[7] that it will publish guidance before 6 April 2016, on how to identify an individual's 'main residence' for these purposes.

HMRC will issue PAYE codes with an 'S' prefix to employers that identify employees subject to U.K. income tax at the Scottish main rates.[8]

Any under- or over-payment of income tax that arises where an individual's status as a Scottish Taxpayer cannot be confirmed until after the end of the relevant tax year will be addressed through the self-assessment system or by a payroll withholding adjustment in a subsequent tax year.

How Income Tax Paid by Scottish Taxpayers Will Operate

From 6 April 2016, the Scottish basic, higher, and additional rates of income tax will be calculated by reducing each of the corresponding U.K. basic, higher, and additional rates of income tax by 10 percentage points and adding the SRIT set by the Scottish Parliament for the relevant tax year.

A single SRIT will apply equally across each of the basic, higher, and additional income tax bands (i.e., Scotland's Parliament will not, for example, be able to raise the higher rate and reduce the basic rate at the same time).

However, draft clauses for the Scotland Bill 2015 published by the U.K. government provide for the Scottish Parliament to be given the power to vary without restriction:

- the rates of income tax to be paid by Scottish Taxpayers on non-savings and non-dividend income; and
- the bands of income to which those rates will apply.

It has not yet been proposed when these further powers will be devolved to the Scottish Parliament.

KPMG Note

Income tax paid at the Scottish main rates will be within the scope of the U.K.'s existing network of double taxation treaties (income tax will remain a single U.K. tax under the care and management of HMRC).

It should not be necessary for employers to review the wording of their tax equalization policies in relation to employees seconded to the U.K. from overseas (since such individuals will be tax equalized by reference to their overseas home country rates).

Employers, however, might wish to consider the potential additional costs of tax equalization associated with seconding employees to a part of the U.K. with higher income tax rates and, potentially, structure secondments such that in-bound secondees have a close connection (either through the location of their main residence or based on days spent there) with part of the U.K. that has lower income tax rates.

Employers might also wish to consider whether it will be necessary to amend the wording of their policies to clarify the positions of U.K. individuals seconded overseas who would have been Scottish Taxpayers had they remained resident in the United Kingdom.

Potential Changes for Welsh Taxpayers

Subject to a referendum to be held in Wales,[9] power to vary the rates of income tax paid by Welsh Taxpayers on non-savings and non-dividend income may be devolved to the NAW.

It has yet to be announced when the proposed referendum will be held (while the U.K. government has expressed the view that this referendum should be held during the term of the next U.K. Parliament,[10] the timing of the referendum depends on the agreement of the NAW).[11]

KPMG Note

As the proposed devolution of income tax varying powers to the NAW is subject to the outcome of a referendum, it is not certain when – or if – these powers will be devolved.

Should income tax varying powers be devolved to the NAW, the criteria for being a Welsh Taxpayer would be in line with those for being a Scottish Taxpayer (and certain minor amendments would be made to the Scottish criteria to avoid an individual being both a Welsh Taxpayer and a Scottish Taxpayer in the same tax year).

KPMG Note (cont'd)

If Welsh Taxpayer status is introduced, the considerations for internationally mobile individuals should be similar to those that relate to Scottish Taxpayer status.

Footnotes:

1 For prior coverage, see *Flash International Executive Alert* 2012-103, 30 May 2012.

2 Scotland Act 1998, section 73.

3 Scotland Act 2012, section 25.

4 See the prospective changes introduced by the Finance Act 2014, Schedule 38.

5 See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397079/Scotland_EnduringSettlement_acc.pdf.

6 See http://www.legislation.gov.uk/ukpga/2014/29/pdfs/ukpga_20140029_en.pdf.

7 HMRC Technical Note May 2012, *Clarifying the Scope of the Scottish Rate of Income Tax*, para 16.

8 Draft Income Tax (Pay As You Earn) (Amendment) Regulations 2015.

9 Wales Act 2014, section 12.

10 Wales Office, *Powers for a Purpose: Towards a Lasting Devolution Settlement for Wales* (Cm 9020, 2015), para. 4.10.

11 Wales Act 2014, sections 12(4), 13.

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