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THE NEW SCOTTISH RATE OF INCOME TAX



The Scotland Act 2012 granted the Scottish Parliament landmark new powers to set a separate annual rate of income tax for Scottish taxpayers. The Scottish rate of income tax (SRIT) came into effect in April 2016 and represents a fundamental change to the UK tax system.

TWO TYPES OF INCOME TAX

Under the new regime, with effect from 6 April 2016, taxpayers who are deemed to be resident in Scotland will pay two types of income tax on their non-savings income.

The main UK rates of income tax will be reduced by 10p for Scottish taxpayers, and the Scottish Parliament will levy the SRIT in its place.

On 11 February 2016, the Scottish Parliament agreed to set the SRIT at 10% for the tax year 2016/17.

WHAT DOES SRIT APPLY TO?

The SRIT applies to most mainstream sources of income such as PAYE income, pensions, rental profit and profits from self-employment.

The SRIT doesn't apply to income from savings such as building society interest or dividends. These types of income will be taxed at the same rates as those that apply for all taxpayers across the UK.

National Insurance contributions are unaffected by the SRIT. In addition, personal allowances remain the same.

Although the overall rates of tax paid by Scottish taxpayers are the same as they paid in 2015/16, the changes will have an impact on many employers and employees, including additional administrative burdens on employers.

THE IMPACT OF THE NEW SYSTEM ON EMPLOYERS

Any employer in the UK will see a change to PAYE procedures if an employee is classed as a Scottish taxpayer. For Scottish income tax purposes, the key criteria for determining an individual's tax status relate to the individual's place of residence, regardless of where the individual works. This means that the change will affect employers based outside Scotland, even if just one of their employees is classed as a Scottish taxpayer.

A new 'S' prefix will be introduced to the tax code of Scottish taxpayers and employers need to make sure that their payroll software is updated to ensure that it is able to apply the correct rates of SRIT. For most Scottish taxpayers qualifying for the standard personal allowance, the tax code will be S1100L.

Employers should not use an 'S' tax code until they are advised to do so by HMRC.

While there is no requirement for employers to identify the SRIT proportion of tax separately on the P60 (end of year certificate), the P60 should show a Scottish tax code where appropriate.



DETERMINING AN INDIVIDUAL TAXPAYER'S STATUS

Whether an individual is deemed to be Scottish for the purposes of paying SRIT will depend on where they live, or reside, during the course of the tax year.

For the vast majority of individuals, the question of whether or not they are a Scottish taxpayer will be a simple one – they will either live in Scotland and thus be a Scottish taxpayer, or live elsewhere in the UK and not be a Scottish taxpayer.

However, Scottish taxpayer status is applicable for an entire tax year, and complications could arise where an individual's residential situation is less straightforward. A series of tests exists in order to help determine taxpayer status in such cases.

The rules governing residence are complex, but an individual who is resident in the UK for tax purposes will be a Scottish taxpayer if they satisfy one of the following tests:

- A. They are a Scottish Parliamentarian
- B. They have a 'close connection' to Scotland, either through:
 - having a **single place of residence**, which is in Scotland, or
 - where they have more than one place of residence, having their **'main place of residence'** in Scotland for at least as much of the tax year as it has been in any one other part of the UK
- C. Where no 'close connection' can be established, it will be necessary to apply **'day counting'**.

Main place of residence

As set out above, for those who have more than one place of residence in the UK it is necessary to determine whether they have a 'close connection' to Scotland or another part of the UK.

Central to this process is establishing which has been their 'main place of residence' for the longest amount of time during the tax year. (Note that the criteria are not the same as those governing the election of a main residence for capital gains tax purposes.)

HMRC guidance includes a range of potential indicators to assist with the process of determining a main place of residence for the purposes of SRIT. These include such areas as:

- the presence of other family members
- where an individual's children go to school
- correspondence address for household bills, credit cards, etc
- how residences are furnished
- where the majority of their possessions are kept
- main residence for council tax records
- voting registration address
- local parking permits
- club memberships
- evidence of social activities, such as dining out locally
- address for the registration and insurance of an individual's car
- GP/dentist/optician registrations.

Counting the days

Where it is not possible to identify a 'close connection' to Scotland or any other part of the UK by means of an individual's place of residence, it will be necessary to apply **day counting** – that is, calculating the number of days spent in Scotland compared with those spent elsewhere in the UK.

Where an individual spends at least as many days in Scotland as the rest of the UK, they will be deemed a Scottish taxpayer. A 'day spent' refers

to where they are at midnight on any given day (unless they are 'in transit').

KEEPING HMRC INFORMED

There is currently no legislation in place that states taxpayers need to keep HMRC informed of a change in address. However, it is important that taxpayers inform HMRC of any change of address during the course of the year, as this could trigger a change in their taxpayer status.

FUTURE CHANGES

As well as paving the way for the changes to income tax, the Scotland Act 2012 also resulted in the introduction of the new Land and Buildings Transaction Tax (LBTT) in Scotland, replacing the Stamp Duty Land Tax applying in the rest of the UK, as well as changes to the landfill tax regime in Scotland.

An LBTT supplement, called the Additional Dwelling Supplement (ADS), has been introduced from 1 April 2016 on purchases of additional residential properties, such as buy-to-let properties and second homes. This supplement is 3 percentage points of the total price of the property for all relevant transactions above £40,000 and is levied in addition to the current LBTT rates.

The Scotland Act 2016 proposes the further devolution of additional tax and spending powers to the Scottish Parliament.

Key points

- ✓ Employers should ensure that their payroll software is updated in order to deal with the new SRIT.
- ✓ The new rules could affect employers outside Scotland, if they have employees resident in Scotland for SRIT.
- ✓ Employers are encouraged to help ensure that their employees keep HMRC updated with any relevant changes to their personal details.
- ✓ Employers should not make changes to an employee's tax status unless advised to by HMRC.
- ✓ For some taxpayers it may be advisable to retain certain records and documents, such as household bills and bank statements, to help with the process of determining their taxpayer status.

With additional devolutionary tax measures in the pipeline, business owners are advised to ensure that they keep abreast of the latest developments.



The rules governing residential status are complex, and it is always advisable to seek professional guidance.