United Kingdom: How will the new Scottish rates of income tax impact your organization?

May 15, 2018

In brief

The Scotland Act 2016 provides the Scottish Government with the power to set both income tax rates and bands for Scottish taxpayers who have non-savings and non-dividend income, such as employment, pensions, and rental income. This excludes the UK tax-free personal allowance, which will continue to be set by the UK Government, as will income tax rates on savings income such as bank interest and dividend income.

These powers are not new, but to date the Scottish Government has only exercised its powers on a limited basis. This has changed with effect from April 6, 2018 and the introduction of five rates of income tax for Scottish taxpayers.

Employers should understand who is a Scottish taxpayer and how the new tax rates are applied from a compliance and reporting perspective. This is particularly important for employers with globally mobile employees as there are likely to be cost implications which the business should be aware of from a policy and budgetary perspective.

In detail

What is changing?

The following income tax rates and bands will apply to Scottish taxpayers versus taxpayers resident elsewhere in the UK (rUK) as of April 6, 2018.

Scottish tax bands	Scottish band name	Scottish tax rates	rUK tax bands	rUK band name	rUK tax rates
£0 to £11,850*	Personal allowance	0%	£0 to £11,850*	Personal allowance	0%
Over £11,850 to £13,850	Starter rate	19%	N/A	N/A	N/A
Over £13,850 to £24,000	Basic rate	20%	Over £11,850 to £46,350	Basic rate	20%
Over £24,000 to £43,430	Intermediate rate	21%	N/A	N/A	N/A
Over £43,430 to £150,000**	Higher rate	41%	Over £46,350 to £150,000	Higher rate	40%
Over £150,000	Top rate	46%	45%	Additional rate	45%

** Assumes the person is in receipt of the UK personal allowance.*

*** The personal allowance is reduced by £1 for every £2 of income earned above £100,000.*

This means that a Scottish taxpayer who earns £100,000 per annum is now £1,324 worse off per annum when compared to colleagues who are tax resident elsewhere in the UK, as illustrated by the table below. The financial impact will be even greater for employers that have globally mobile assignees in the UK who are deemed to be Scottish taxpayers and are tax equalised.

	Gross income	Scottish income tax	Gross income	rUK income tax
Personal allowance	£11,850	£0	£11,850	£0
19%	£2,000	£380	N/A	N/A
20%	£10,150	£2,030	£34,500	£6,900
21%	£19,430	£4,080	N/A	N/A
40%	N/A	N/A	£53,650	£21,460
41%	£56,570	£23,194	N/A	N/A
45%	N/A	N/A	£0	£0
46%	£0	£0	N/A	N/A
Total		**£29,684**		**£28,360**

Who is impacted?

Scottish income tax is only payable by Scottish taxpayers. In order for an individual to be a Scottish taxpayer, he or she first must be UK tax resident under the UK statutory residence test. This means that if an individual only works in Scotland when in the UK, and is a non-resident in the UK, they will be subject to rUK tax rates and not the Scottish rates of income tax.

Once it has been established that an individual is resident in the UK, it is necessary to consider if they satisfy any one of the following three tests:

1. They are a member of the Scottish Parliament; or
2. They have a 'closer connection' to Scotland through either having a single place of residence that is in Scotland, or where they have more than once 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 other individual part of the UK (i.e., compared to the time for which it was in England, Northern Ireland, or Wales individually); or
3. Where there is no 'close connection' to Scotland or any other part of the UK, they will be considered a Scottish taxpayer if they spend more days in Scotland (a day being any day that they are in Scotland at midnight) than in other parts of the UK in aggregate.

It is vital that employees keep their address up-to-date with HM Revenue and Customs (HMRC) because, among other reasons, this is what HMRC will use to determine if they are a Scottish taxpayer.

Note that a main residence can include property that is rented as well as employer-provided accommodation.

Common misconceptions

The definition of a Scottish taxpayer is not connected to where their employer is based or where the employee works or even whether they were born in Scotland. Rather, in the majority of cases it will be based on the individual's main residence. Where this is not identifiable or they fail to have a closer connection with Scotland or any part of the UK, they will need to track where they are each day at midnight for day-count purposes.

For the majority of employees who have only one home in Scotland, it will be clear that they are a Scottish taxpayer. If an individual has two main places of residence at different times in the tax year – for example, if they relocate from London to Edinburgh part-way through the year – they will be a Scottish taxpayer if their Scottish home was their main place of residence for at least half of the tax year.

More complex cases may arise where an individual has two places of residence at the same time during the year and spends time in each. If this is the case, they will need to make a decision on which location will be their 'main place of residence.'

Whether a residence constitutes a **'main place of residence'** for the purposes of Scottish taxpayer status is a qualitative, rather than quantitative test. Factors that may be considered include:

- Where the majority of their possessions are kept
- Where their family lives (i.e., spouse, long-term partner, or dependent children)
- Where they have registered their bank accounts; the location of their general practitioner doctor and dentist; where they are registered to vote
- Whether they are a member of local clubs or societies.

Example

Sarah's family home is in London, England but she works in Edinburgh, Scotland from Monday to Friday where she rents a flat. Both properties are fully furnished, and she keeps possessions in each. She stays in her Edinburgh flat Monday to Friday and returns home to London each weekend. All her friends are in London, and she is a member of a local sports club in Edinburgh and London. She also uses her London home as her main address when registering to vote and setting up her bank accounts. She is also registered with a doctor and dental practice in London. Despite spending most of her time in Edinburgh, Sarah's main home is in London; therefore, she would not be considered a Scottish taxpayer.

Other considerations

These changes bring a number of additional complexities, especially concerning tax relief for gift aid donations and personal pension contributions.

The takeaway

What does this mean for employers?

Employers should consider the following questions:

- What communications, if any, do you want to issue to your employees to advise them of the new Scottish income tax rates and the importance of ensuring that their PAYE code is correct to ensure you apply the appropriate withholding rates?
- What impact will this have on your employer reporting obligations? For example, how will this affect annual PAYE Settlement Agreements?
- Will you require an inter-UK tax equalisation policy for moves between Scotland and the rUK?
- What impact will this have on cost projections and hypothetical tax calculations for globally mobile employees who are or were Scottish taxpayers and are tax equalised?
- What impact will this have on the treatment of trailing liability payments for globally mobile employees?
- If you operate a modified payroll for tax equalised assignees to the UK, how will you identify those who are Scottish taxpayers?

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your regular Global Mobility Services engagement team or one of the following team members:

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