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The Scottish Budget

The Scotland Act 2016 devolved more landmark powers to the Scottish Government and on 15 December, the Finance Secretary, Derek Mackay, presented the draft Scottish Budget for 2017/18. This factsheet outlines some of the key proposals from April 2017, including the Government's plans for Scottish income tax bands and rates.

Income tax for Scottish taxpayers

The Scottish Rate of Income Tax (SRIT)

On 6 April 2016, a fundamental change was made to the taxation system for Scottish resident individuals. The main UK rates of income tax were reduced by 10p for Scottish taxpayers and in its place the SRIT was applied equally to all Scottish taxpayers. As the SRIT was set at 10p, the overall income tax rates are currently the same as in the rest of the UK. So, those who are resident in Scotland are currently liable to two types of income tax and pay SRIT at 10% on most mainstream sources of income such as PAYE income, pensions, rental profit and profits from self-employment.

The SRIT does not apply to income from savings such as building society interest or dividends. These rates are the same for all taxpayers across the UK.

Gift Aid donations and relief at source on personal pension contributions continue to apply at the UK basic rate (20%), regardless of the tax position of the donor. Scottish taxpayers are able to claim relief equal to the difference between the Scottish basic and higher or additional rates.

The SRIT was in place for one transitional year and will no longer apply from 6 April 2017 as the Scottish Government have exercised their powers to set the tax rates and bands (excluding the personal allowance) on non-savings, non-dividend income of Scottish taxpayers.

2017/18 tax bands and rates

The Scottish Government is proposing to freeze the Scottish basic rate of income tax at 20% and also to freeze the Scottish higher and Scottish additional rates at 40% and 45% respectively. In addition, the higher rate income tax threshold will increase by inflation to £43,430 in 2017/18. The additional rate of tax of 45% remains payable on taxable income above £150,000. The Scottish Government also confirmed that the higher rate income tax threshold will increase by a maximum of inflation in all future years of this Parliament.

The Scottish Government has therefore not followed the UK Government's plans to extend the threshold for paying the higher rate level of income tax of 40p from £43,000 to £45,000 for 2017/18. This means that a Scottish higher rate taxpayer will pay £314 more tax in 2017/18 than a UK higher rate taxpayer, being £1,570 at the marginal rate of 20% (40% - 20%).

Personal allowance for Scottish and other UK taxpayers

The personal allowance is currently £11,000. Legislation has already been enacted to increase the allowance to £11,500 for 2017/18.

The personal allowance is available to Scottish and other UK taxpayers, however, not everyone has the benefit of the full personal allowance. There is a reduction in the personal allowance for those with 'adjusted net income' over £100,000, which is £1 for every £2 of income above £100,000. So for 2016/17 there is no personal allowance where adjusted net income exceeds £122,000. For 2017/18 there will be no personal allowance available where adjusted net income exceeds £123,000.

Income tax bands across the rest of the UK

The UK basic rate of tax is currently 20%. The band of income taxable at this rate is £32,000 so that the threshold at which the 40% band applies is £43,000 for those who are entitled to the full personal allowance.

UK legislation has already been enacted to increase the basic rate band to £33,500 for 2017/18. The higher rate threshold will therefore rise to £45,000 in 2017/18 for those entitled to the full personal allowance.

The additional rate of tax of 45% remains payable on taxable income above £150,000.

Who pays Scottish income tax?

Broadly, a Scottish taxpayer is someone who is UK resident for tax purposes and has one place of residence which is in Scotland.

Individuals who have more than one place of residence in the UK need to determine which of these has been their main place of residence for the longest period in a tax year. Individuals who cannot identify a main place of residence will need to count the days they spend in Scotland and elsewhere in the UK. If they spend more days in Scotland, they will be a Scottish taxpayer.

Determining an individual taxpayer's status

Whether an individual is deemed to be Scottish for the purposes of paying Scottish income tax rates 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:

1. having a **single place of residence**, which is in Scotland, or
2. 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 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 Scottish income tax. 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').

Employers

Employers should be aware that if an employee is classed as a Scottish taxpayer then a special PAYE code (S) will apply and this will be notified to employers and pension providers by HMRC where appropriate.

An employer does not have to make any assessments on taxpayer status. Employers should not change a tax code unless advised to do so by HMRC. Employers of Scottish taxpayers will need to ensure their payroll software has the capability to deal with S codes.

HMRC's Employer Bulletin for December 2016 asks that employers remind their employees of the importance of keeping HMRC informed of their correct address details as this information is crucial in determining whether or not they are a Scottish taxpayer. Taxpayers can check and update their address details through their online Personal Tax Account. For those individuals who have not yet used their account they can register at **www.gov.uk/personal-tax-account**.

Land and Buildings Transaction Tax (LBTT)

LBTT replaced UK Stamp Duty Land Tax in Scotland from 1 April 2015. LBTT is a tax applied to residential and commercial land and buildings transactions (including commercial leases) where a chargeable interest is acquired.

The LBTT rates for residential properties are as follows:

Residential property	LBTT Rate %
£0 - £145,000	0
£145,001 - £250,000	2
£250,001 - £325,000	5
£325,001 - £750,000	10
£750,001 and over	12

The LBTT rates apply to the portion of the total value which falls within each band in respect of transactions. In 2017/18 the Scottish Government will maintain the LBTT rates shown above.

Additional Dwelling Supplement on additional residential properties

The Additional Dwelling Supplement (ADS) was introduced from 1 April 2016 and is payable on purchases of additional residential properties (above £40,000).

The main target of the ADS is purchases of buy-to-let properties or second homes. However, there will be some purchasers who will have to pay the additional charge even though the property purchased will not be a buy-to-let or a second home. The 18 month rules set out below will help to remove some transactions from the additional rates (or allow a refund). Care will be needed if an individual already owns, or partly owns, a property and transacts to purchase another property without having disposed of the first property.

The ADS rate is set at three percentage points above the standard LBTT rates and the Government does not intend to change this rate for 2017/18. ADS potentially applies if, at the end of the day of the purchase transaction, the individual owns two or more residential properties. The ADS applies to the full purchase price of the transaction.

The 18 month rules – further details

- Purchasers will have 18 months to claim a refund of ADS if they buy a new main residence before disposing of their previous main residence
- Purchasers will also have 18 months between selling a main residence and replacing it with another main residence without having to pay ADS
- ADS has been enacted with 18 month periods rather than 36 months, the period for Stamp Duty Land Tax which applies across the rest of the UK.

The Scottish Government has LBTT calculators which work out the amount of LBTT payable. The calculators can be found at www.revenue.scot/land-buildings-transaction-tax/tax-calculators.

Air Passenger Duty

The Scottish Government has also been given new powers in other areas, including provision for a tax to replace Air Passenger Duty (APD) in Scotland.

The Government has confirmed that it will introduce a Bill in the first year of the current Parliament to establish the tax which will replace APD in Scotland from 1 April 2018. The Scottish Parliament has said it is committed to delivering a 50% reduction in the overall tax burden of APD by the end of this Parliament.

For more information and to discuss how the Scottish tax rules may affect you, please contact us. We would be delighted to assist you.