TURCAN CONNELL

Briefing Note

The Scotland Act 2012 – What does it mean for you?

The Scotland Act 2012 has the potential to bring about the biggest changes to taxation in Scotland since the 1980s. David Welsh sets out what the financial section of the Act means for you and how your personal finances could be affected by the changes.

What is the Scotland Act?

Although not widely publicised, the Act is a very important piece of Westminster legislation which is designed to increase the number of devolved powers, enabling the Scottish Government to be increasingly fiscally autonomous.

Will the Act affect my finances?

Personal finances are going to be directly affected by the Act in two ways. Firstly, the Act contains substantial changes to the way in which income tax is paid. The concept of a "Scottish rate" of tax will be introduced which will apply only to taxpayers in Scotland.

The Act also removes Scotland from the scope of stamp duty land tax (SDLT) but grants to the Scottish Government the power to introduce a tax on land transactions in its place.

But the Scottish Government already has the power to alter income tax, doesn't it?

In a way, yes. The Scottish Government was given the power under the 1998 Act to alter income tax by three percentage points either way. However, because of the way that this power was worded, the Scottish Government was under no obligation to make any mention of income tax rates in its budget.

This all changes with the new Act. For Scottish taxpayers, the rate of income tax set by the UK Government will be reduced by 10 percentage points. The Scottish Government will then determine the Scottish rate through its own budget. Therefore, even if the Scottish Government wants to retain the same income tax rates as the rest of the UK, it must set the Scottish rate at 10%, cancelling out the reduction.

It is the Scottish rate which is allocated directly to the Scottish Government's budget each year.

Who is defined as a Scottish taxpayer?

The Act introduces a residence test to determine where in the UK a taxpayer is resident for these purposes. There are broadly three ways in which a UK-resident taxpayer will be regarded as resident in Scotland for tax purposes:

1. If his/her only or main home is in Scotland, he/she will be resident in Scotland.

2. If he/she has no home in the UK but spends more time in Scotland than in any other part of the UK, he/she will be resident in Scotland.

3. If he/she is an MP, MSP or MEP for a Scottish Constituency, he/she will be resident in Scotland.

It is clear, therefore, that if a taxpayer's only, or main, home is in England, he/she will not be a Scottish taxpayer and he/she will continue to be taxed as at present. Having a Scottish property does not automatically mean that the owner will be a Scottish taxpayer.

Do the changes affect all income?

No, and this is where things start to get complicated for a Scottish taxpayer. At its most basic, the Scottish rate of income tax only applies to income received from salaries, profits from self-employment and pension income. It does not apply to bank interest and nor does it apply to dividend income.

Therefore, someone with a salary in the higher-rate bracket with substantial savings and an investment portfolio could find themselves paying income tax at several different rates on the various slices of their income.

When will the changes to income tax come into effect?

Although the Act received royal assent this year, the Scottish rate of income tax will likely not be introduced until the tax year 2016/2017 by which time the independence referendum will have been held and the outcome known for some time.

What about the changes to SDLT?

It is very difficult to know exactly how this will work because the Scottish Government has been given the power to start from scratch and create an entirely new tax.

We have been told, however, that the abolition of SDLT under the Act will be postponed until the Scottish Government has had the opportunity to debate and discuss its replacement.

Are any other taxes affected?

The Act does not grant the power to alter any part of capital gains tax and nor does it allow the Scottish Government to change any part of the corporation tax or inheritance tax legislation. The Act does, however, include a power enabling the Westminster Government to devolve additional taxation powers to the Scottish Parliament without the need for further legislation.

What are the practical effects?

Scotland will have the most complicated income tax legislation in the UK if the Scottish Government sets the Scottish rate at anything other than 10%. At the moment it is difficult to see how HM Revenue & Customs would be able to cope with such an upheaval without huge capital investment in its IT systems.

For tax reliefs such as gift aid, it is unclear at which rate they will be given if the Scottish rate of income tax differs from the rest of the UK and indeed from which “pot” the tax reclaim will be taken first. The same applies to pension contributions: if the contributor is Scottish-resident but the pension is in England, at what rate will the tax relief be given and how will this be managed?

It is clear that the Act has the ability to bring about big changes for the Scottish taxpayer and, for the first time, where in the UK one calls home will become important for income tax.

If you would like to discuss any of the above matters further, please get in touch with your usual contact at Turcan Connell. We will be keeping a close eye on developments and our website will contain up-to-date coverage.