EXPLANATORY MEMORANDUM TO

THE DEVOLVED INCOME TAX RATES (CONSEQUENTIAL AMENDMENTS) ORDER 2018

2018 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The power to set rates of income tax for Welsh taxpayers is being devolved to the National Assembly for Wales. These Welsh rates of income tax will apply to the non-savings, non-dividend income of Welsh taxpayers from 6 April 2019.

2.2 The introduction of the Welsh rates of Income Tax will have implications for other parts of the income tax system. This instrument makes consequential amendments to aspects of the income tax regime that are not devolved to ensure that Welsh taxpayers obtain certain tax reliefs or are taxed on certain types of income at the Welsh rates.

2.3 Two of the amendments similarly affect Scottish taxpayers to ensure they obtain tax reliefs or are taxed at the appropriate Scottish rates. These relate to reductions in the residuary income of a deceased's estate (paragraph 7.7) and Gift Aid (paragraph 7.10).

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland and Northern Ireland.

3.3 The powers under which this instrument is made cover the entire United Kingdom (see section 30 of the Wales Act 2014 (c.29)) and the territorial application of this instrument is not limited either by the Act or by the instrument.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 The Rt. Hon Mel Stride, Financial Secretary to the Treasury, has made the following statement regarding Human Rights:

"In my view the provisions of the Devolved Income Tax Rates (Consequential Amendments) Order 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 Section 8 of the Wales Act 2014 amended the Government of Wales Act 2006 (c. 38) so as to insert sections 116D to 116K. Section 116D provides that the National Assembly for Wales may set Welsh rates for the purpose of calculating the Welsh basic, higher and additional rates of income tax. The Wales Act 2014 (Commencement No.2) Order 2018 (S.I. 2018/892 (C.70)) brought section 8 of the Wales Act 2014 and sections 116D to 116K of the Government of Wales Act 2006 into force with effect from 6 April 2019.

6.2 Section 80C of the Scotland Act 1998 (c.26) as amended by Scotland Act 2016 (c.11) provides that the Scottish Parliament may set rates and thresholds of income tax for Scottish taxpayers. This power was capable of being exercised for the first time in respect of the tax year 2017-18.

6.3 These amendments will work alongside other amendments consequential on the introduction of WRIT which are being made to The Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) in a separate instrument.

6.4 This is the first use of the powers conferred by section 28(1) and (2) of the Wales Act 2014.

7. Policy background

What is being done and why?

7.1 Part 2 of the Wales Act 2014 gave the National Assembly for Wales the power to set Welsh rates of income tax on non-savings, non-dividend income for Welsh taxpayers. These powers will apply for the tax year 2019-20 and subsequent tax years. This Order amends a number of areas of the Income Tax Acts to deal with consequential changes needed to allow for the potential differences between the Welsh basic, higher and additional rates and the UK basic, higher and additional rates. These include provisions, amongst others, on relief at source on pension contributions and Gift Aid relief.

7.2 In two cases (see section 7.7 'reduction in the residuary income of a deceased's estate' and section 7.10 'Gift Aid') amendments are also made in respect of Scottish rates of income tax to allow for the scenario where the Scottish basic rate is different from the UK basic rate.

Amendments to the Taxes Management Act 1970

7.3 This instrument amends section 91 of the Taxes Management Act 1970, which deals with the treatment of interest on overdue income tax when reliefs are subsequently given. A reference is inserted to the Welsh basic rate to ensure that the section works as is intended for Welsh taxpayers.

Amendments to the Finance Act 2004

7.4 The instrument makes consequential changes to the rules covering relief at source on pension contributions to ensure that Welsh taxpayers receive relief at the Welsh basic rate through relief at source and that those who pay income tax at a rate higher than the Welsh basic rate will be entitled to relief for their contributions, reflective of Welsh income tax rates.

7.5 Chapter 5 of Part 4 of the Finance Act 2004 contains a number of special tax charges. The majority of these are designed to generate a charge which is based broadly on current rates, so actual percentages are used in the legislation. In two areas though there are specific references to rates and thresholds. This instrument amends section 227 (the annual allowance charge) and section 237B ('scheme pays' rules) to ensure that, where the individual is a Welsh taxpayer, references to rates are references to Welsh rates.

Amendments to the Income Tax (Trading and Other Income) Act 2005

7.6 In some circumstances, deficiency relief may be available to individuals when a life insurance policy or contract comes to an end. This instrument makes amendments to ensure that, where an individual is a Welsh higher rate taxpayer, relief is given at the Welsh higher rate.

7.7 This instrument amends section 669, which provides for a reduction in the residuary income of a deceased's estate in certain circumstances, to reflect the fact that the Scottish and Welsh rates of income tax may not correspond to the rates that apply to the remainder of the UK.

7.8 This instrument amends section 685A, which provides for a tax credit where a person other than a settlor receives an annual payment from a settlor-interest trust, to ensure that where that person is a Welsh taxpayer, the credit is calculated at the Welsh additional rate.

Amendments to the Income Tax Act 2007

7.9 This instrument makes consequential amendments to the rules covering Gift Aid to address the situation whereby the Welsh and/or Scottish basic rates are set at a higher rate than the UK basic rate, to ensure that the donor is able to receive the benefit of the relief that has not been claimed by the charity (the difference between the UK basic rate and the higher Scottish or Welsh basic rate). It also makes amendments to address the situation whereby the Welsh and/or Scottish basic rates are set at a rate lower than the UK basic rate, to ensure that Scottish or Welsh taxpayers whose marginal rate is above the UK basic rate do not benefit by more than the relief which has not been claimed by the charity (the difference between the UK basic rate and the lower Scottish or Welsh basic rate).

7.10 This instrument amends sections 55B and 55C to apply the Welsh basic rate for Welsh taxpayers in calculating the amount of tax reduction available under the transferable tax allowance for married couples and civil partners.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 As this instrument amends primary legislation, there is no consolidation required.

10. Consultation outcome

10.1 A draft statutory instrument was published on GOV.UK for technical consultation on 22 October 2018, alongside a Technical Note explaining the policy intent.

10.2 We received seven responses to the consultation. Comments were mostly about clarifying our policy approach. There were no comments on the draft statutory instrument. The consultation was limited in time and scope because the amendments reflect the position already in place for Scottish income tax (which was consulted upon in 2015) and are technical in nature.

10.3 A draft statutory instrument was shared and discussed with the Welsh Government, who were content with the provisions.

11. Guidance

11.1 A Technical Note setting out the policy positions covered by this statutory instrument was published on 22 October 2018 at www.gov.uk/government/consultations/clarifying-the-scope-of-the-welsh-rates-of-income-tax-technical-note-and-draft-legislation

11.2 More general guidance on the operation of Welsh rates of Income Tax is available on GOV.UK at www.gov.uk/welsh-income-tax and on defining Welsh taxpayers at www.gov.uk/hmrc-internal-manuals/welsh-taxpayer-technical-guidance

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 An Impact Assessment covering this instrument was published on 10 June 2014 alongside the draft clauses and explanatory notes for the Wales Bill and is available on the website at https://www.parliament.uk/documents/impact-assessments/IA14-12.pdf. It remains an accurate summary of the impacts that apply to this instrument.

12.4 It is expected to have negligible impact because HMRC will determine whether people are Welsh taxpayers and inform employers of their employees' tax code in the same way as they do now.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 To minimise the impact of the requirements on small business HMRC will determine whether people are Welsh taxpayers and inform businesses of their employees' tax code in the same way as they do now.

13.3 The approach taken is consistent with that already in place for Scottish income tax.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is to review the outcome as appropriate based on experience of administrating the Welsh rates of income tax once they have been introduced.

14.2 The regulation does not include a statutory review clause because sub-section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 applies.

15. Contact

15.1 Paul Stansfield at HM Revenue and Customs Telephone: 03000 583473 or email: paul.stansfield@hmrc.gsi.gov.uk can be contacted with any queries regarding the instrument.

15.2 Narmada de Silva, Deputy Director for Strategic and Cross Cutting Policy at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.

15.3 Rt. Hon Mel Stride MP, The Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.