EXPLANATORY MEMORANDUM TO

THE INCOME TAX (PAY AS YOU EARN) (AMENDMENT No. 3) REGULATIONS 2015

2015 No. 1667

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

2. Purpose of the instrument

2.1 The Scottish rate of income tax (SRIT) introduced in the Scotland Act 2012 (c. 11) is used to calculate the Scottish basic rate, higher rate and additional rate. It is expected that these rates of tax will apply to the non-savings income of a Scottish taxpayer from April 2016.

2.2 This instrument makes consequential amendments to the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) (the 2003 Regulations) to reflect SRIT on non-savings income and to provide for the deduction and reporting of SRIT through the Pay As You Earn (PAYE) system.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The 2003 Regulations govern the operation of the PAYE system under which Income Tax is deducted at source from an employee's pay. Certain other deductions are also made under the PAYE system.

4.2 Regulation 3 amends regulation 2 of the 2003 Regulations by including a reference to the Scottish rate of income tax in the definitions of "additional rate", "basic rate" and "higher rate" and by inserting definitions of "Scottish rate" and "Scottish taxpayer".

4.3 Regulation 4 amends regulation 7 of the 2003 Regulations to include a definition of the phrase "S code" which indicates that for the purposes of the PAYE system the employee is a Scottish taxpayer and will be taxed as such on any PAYE income.

4.4 Regulation 5 amends regulation 133A of the 2003 Regulations by inserting a definition of "basic rate" and "higher rate" for the purposes of Chapter 2A of Part 7 of the 2003 Regulations which applies where

the Department for Work and Pensions pays a social security pension lump sum.

4.5 These amendments will work alongside others amendments consequential on the introduction of SRIT which were made in Schedule 38 to the Finance Act 2014 (c. 26) and in the Scottish Rate of Income Tax (Consequential Amendments) Order 2015 which was laid before Parliament in draft in June 2015.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 The Scotland Act 2012 introduced SRIT which it is expected will be implemented from April 2016. SRIT will apply only to income from earnings, pensions and other non-savings sources.

7.2 The Scottish basic rate, higher rate and additional rate paid by Scottish taxpayers will be calculated by reducing the UK basic, higher and additional rates of Income Tax by 10 pence in the pound and adding the Scottish rate income tax set by the Scottish Parliament.

7.3 Employers will be required to deduct tax at source under the PAYE system calculated at the Scottish rate of income tax for each employee who is a Scottish taxpayer.

7.4 These amendments to the 2003 Regulations make the necessary consequential changes to reflect the Scottish rate of income tax.

7.5 Where the Department for Work & Pensions (DWP) pays a social security pension lump sum, they are required to deduct tax at either the rate notified by the recipient of the lump sum or at the basic rate if no rate has been notified. Tax will not be deducted at the appropriate Scottish rate where a Scottish taxpayer receives one of these payments. DWP will continue to deduct tax at the basic or higher rate which applies for England, Wales and Northern Ireland. HMRC will calculate whether the correct tax has been paid at the end of the tax year as part of the end of year reconciliation HMRC undertakes to ensure the right amount of tax has been paid by an individual. Where tax has been underpaid HMRC will request the amount due and refund tax where it is overpaid.

- ***Consolidation***

7.6 There are currently no plans to consolidate the 2003 Regulations.

8. Consultation outcome

8.1 In accordance with the Government's Tax Consultation Framework, on 19 December 2014, a draft of this instrument accompanied by a Technical Note "Clarifying the Scope of the Scottish Rate of Income Tax" was published on the Gov.UK website for comment.

8.2 This Technical note provided an update to an earlier Technical Note, published in May 2012 which set out the Government's policy intentions in areas where the rate setting power of the Scotland Act 2012 interacts with other areas of the income tax system.

8.3 The amendments to the 2003 Regulations published for consultation included a requirement for employers to show details of SRIT, paid by Scottish taxpayers, on P60s they issued to their employees at the end of the tax year. Representations received said that doing so would impose a burden on employers and others running a payroll. As a consequence it has been decided not introduce this requirement.

9. Guidance

9.1 Extensive guidance concerning the operation of PAYE has been published on both the HMRC and Gov.uk websites, viewable by both employers and individuals. This will be updated to reflect these changes.

10. Impact

10.1 This change impacts on all employers who employ a Scottish taxpayer as their payroll systems will need to be able to deal with these taxpayers regardless of where the employer is based.

10.2 The introduction of the Scottish Rate of Income Tax is unlikely to have any impact on Tax charities and voluntary bodies in their role of assisting the public.

10.3 A Tax Information and Impact Note covering the legislative changes from the Introduction of the Scottish Rate of Income Tax was published on 19 March 2014 at Budget and is available at http://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins.

It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 This legislation applies to small businesses.

11.2 Employers with employees who are Scottish taxpayers will be required to operate PAYE calculated at the Scottish rate of income tax rather than at the rate that they are required to apply at the moment.

12. Monitoring & review

12.1 The legislation contained within this instrument will be monitored and reviewed as appropriate within the context of the wider legislative scheme on SRIT.

13. Contact

Paul Harris at HMRC tel. 03000 586519 or email: paye.policy@hmrc.gsi.gov.uk can answer any queries regarding the instrument: