Devolution Of Taxes In The UK

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Introduction

Until the start of the UK's devolution process some 20 years ago, the UK tax system applied equally to taxpayers in all parts of the country. This meant that a multinational company wishing, say, to set up a branch in Northern Ireland to invest in property in Wales, while also having some employees in Scotland, did not need to worry about where in the UK its staff, operations or investments were based. In recent years, however, more devolved tax powers have been introduced, and this means that in future multinationals will need to take care to understand the specific tax consequences of basing their activities in different parts of the UK. With that in mind, this article provides an overview of the current state of the devolved tax system in the UK, as well as a sketch of planned developments.

Background

Devolution in the UK began following referendums in both Scotland and Wales in September 1997, with voters choosing to establish the Scottish Parliament and the National Assembly for Wales ("**Welsh Assembly**"). Devolution to Northern Ireland and the establishment of the Northern Ireland Assembly ("**NI Assembly**") followed shortly afterwards, as part of a far-reaching settlement concluded in May 1998.

The extent and nature of devolution varies between the different nations of the UK. Broadly speaking, the Scottish Parliament and NI Assembly are free to legislate in relation to any matter that is not expressly reserved to the UK parliament;[1] other than "devolved taxes," tax-related matters are essentially reserved.[2] By contrast, the Welsh Assembly does not have a general power to legislate, and may only legislate in those specific areas which have been devolved to it; in relation to tax, only "devolved taxes" are within the Welsh Assembly's competence.[3] As described below, the only devolved taxes which have been provided for so far are land transaction and landfill taxes in Scotland[4] and Wales,[5] although more limited devolution has also taken place in relation to the rates and thresholds of other taxes.

It should also be noted that, although there is no devolution as such to England at present, a new procedure whereby only members of the UK Parliament who represent constituencies in England or England and Wales will vote on measures deemed to affect just those UK nations (known as "English votes for English laws") may presage further tax developments on this front as well.[6]

Land Taxes

Before April 1, 2015, stamp duty land tax ("**SDLT**") was relevant to land transactions in all parts of the UK. With the introduction of Land and Buildings Transaction Tax ("**LBTT**"),[7] LBTT (and not SDLT) is generally chargeable in relation to transactions involving Scottish land and buildings.[8] Although LBTT is broadly based on SDLT, there are a number of differences between LBTT and SDLT, notably with regard to rates and thresholds. The broad overall effect of these differences is that transfers of residential properties worth up to GBP333,000 and commercial properties worth up to GBP1.95m in Scotland attract lower amounts of tax than in the rest of the UK, and that more tax is payable in Scotland for properties worth more than those amounts, meaning that investors looking to acquire portfolios of property across the UK will have to pay attention to potentially increased transaction costs in Scotland.

There are also a number of other notable differences between LBTT and SDLT, such as the fact that the top SDLT rate of 15 percent for transfers of residential properties worth over GBP500,000 to companies is not mirrored in the LBTT provisions, and the way tax is calculated and administered in relation to leases.[9] In addition, SDLT is not infrequently modified, and, although LBTT uses SDLT as a basis, changes to SDLT may not necessarily be picked up by the Scottish Parliament (although it was announced that an equivalent of the forthcoming supplementary 3 percent SDLT charge on transfers of "additional" residential properties will also be introduced for LBTT).[10]

The Welsh Assembly was permitted in 2014 to introduce a new tax which would apply to transactions involving interests in land located in Wales. This tax will, however, only come into effect once SDLT has been disapplied in relation to Wales by the central UK government;[11] legislation is currently under development.[12] There has been no equivalent devolution in Northern Ireland as yet.

Income Tax

Income tax is payable in the UK by individuals on their income (as opposed to their capital gains); depending on a taxpayer's level of income, "basic," "higher," and "additional" rates are incrementally applied. Devolution of income tax, like that of corporation tax (on which see further below), has so far been limited to the power to set different rates; unlike, for instance, LBTT, there has been no general restructuring of the system of these taxes as part of the devolution process. As income tax powers have begun to be devolved, however, what part of the country investors in the UK (as well as domestic companies) choose to employ individuals in is increasingly likely to affect the compensation actually received by those individuals.

The Scottish Parliament was first given the power to vary (by no more than 3 percent) the basic rate of income tax set by the UK Parliament for individual Scottish taxpayers from the tax year 2000/01 onwards. This power did not apply to savings or dividend income, and was not exercised by the Scottish Parliament.[13] With effect from April 2016, Scotland's powers to vary the rate of income tax have been extended;[14] the current position is that the centrally-set higher and additional rates (and not just the basic rate) are reduced by 10 percentage points, and the Scottish Parliament then has the power to set a Scottish rate of income tax ("**SRIT**")[15] to be applied on top of these reduced rates. The SRIT can be set at zero and there is no upper limit; the SRIT, like the previous devolved rates, does not apply to savings or dividend income, which remains chargeable at the main UK rates. However, this system of SRIT gives the Scottish Parliament limited flexibility, since increases or decreases must be applied equally to all tax bands, and for this reason the Scottish government has confirmed that SRIT for the 2016/17 tax year will be 10 percent – in other words, the same level of tax will be charged in the whole of the UK.[16] Proposals in the draft Scotland Bill 2015-16 go further and will (if enacted) give the Scottish Parliament powers to determine the rates of income tax for Scottish taxpayers (other than in respect of savings and dividend income) without reference to the general UK rates, as well as the thresholds at which Scottish rates would apply.[17]

Legislation has also been enacted to give the Welsh Assembly the ability to set the income tax rate for individual Welsh taxpayers in a similar manner to the current variation to the system of making amendments to centrally-set rates that currently applies in Scotland,[18] although, unlike the current Scottish system, each Welsh rate may be varied by a different amount.[19] Originally, this legislation required ratification by a referendum before entering into force; although no referendum has been held, it has recently been announced by the UK Government that the obligation to hold a referendum will be removed.[20]

For income tax purposes, "Scottish taxpayers" and "Welsh taxpayers" are defined in similar terms as UK resident taxpayers that either have a close connection with the relevant jurisdiction (defined by reference to a taxpayer's main residence), or who do not have a close connection with another part of the UK and who spend more days in Scotland or Wales, as applicable, than in any other part of the UK.[21] Notably, these tests (i) only apply where an individual is found to be resident in the UK for general UK income tax principles, and (ii) apply a completely different test in determining residence to that used for general UK income tax purposes, meaning that employers may need to add an additional level of scrutiny when determining the tax bills of internationally mobile employees.

Corporation Tax

Businesses active in Northern Ireland have felt that they operated at a competitive disadvantage when compared with companies operating in the Republic of Ireland, as a result of the significantly lower corporate tax rates enjoyed by companies south of the border. This has in the past led to inward investment by a number of large multinationals being channeled into the Republic of Ireland, without an equivalent level of investment into Northern Ireland. Recent legislation provides a framework for the NI Assembly to vary the corporation tax rate for Northern Irish companies with effect from a date nominated by HM Revenue & Customs ("**HMRC**"), the central UK tax authority, or the UK Treasury.[22] The Northern Ireland Executive has recently committed to set a rate of Northern Ireland corporation tax ("**NICT**") of 12.5 percent from April 2018,[23] matching the rate applicable to corporate trading income in the Republic of Ireland.

Accordingly, companies that are UK resident will in future be subdivided into "Northern Ireland companies" (chargeable to NICT), and other companies.[24] Companies may only qualify as "Northern Ireland companies" if they carry out certain types of trade and:

- If they fall to be regarded as SMEs under a modified version of general EU definitions, have a workforce spending 75 percent of its working time in Northern Ireland and are able to attribute 75 percent of workforce expenses to such employees[25] (in which case their profits will generally be subject to NICT);[26] or
- If they do not fall to be regarded as SMEs, have what would be regarded a permanent establishment ("**PE**") in cross-border situations[27] (in which case they will essentially attribute profits to their Northern Irish "PE" under standard transfer pricing principles).[28]

It will be interesting to see whether these changes will be sufficient to attract overseas investors who might previously have looked to the Republic of Ireland as a low-tax jurisdiction for coordinating investments in Europe.

VAT

It is a fundamental principle of VAT that it should result in neutrality of competition,[29] and EU law requires that, subject to certain exceptions, within the territory of each member state similar goods and services should bear the same tax burden.[30] Since the UK as a whole is recognized as a single territory under EU law, any devolution of VAT within the UK is difficult without a change in EU law; there is, however, currently legislation which is under way which would result in Scotland being assigned half the UK's VAT attributable to Scotland.[31]

Other Measures

A number of more specialist taxes are also subject to devolution. From April 1, 2015, Scottish landfill tax replaced UK landfill tax in respect of disposals to landfill in Scotland;[32] a Welsh equivalent is under development.[33] Draft legislation is currently under way for air passenger duty and aggregates levy to become devolved Scottish taxes,[34] while the power to set air passenger duty for flights beginning in Northern Ireland was devolved to the NI Assembly in 2012.[35]

The Scottish Parliament has also established a Scottish general anti-avoidance rule, which allows Revenue Scotland to counteract arrangements which are "artificial" and result in a tax advantage in respect of a devolved Scottish tax.[36] This "Scottish GAAR" goes further than the anti-abuse (not, as in the Scottish GAAR, anti-avoidance) rule that applies in the UK generally, and does not include a number of safeguards which were introduced for the UK GAAR. The Scottish GAAR will apply if two conditions are met:

(a) It is reasonable to conclude that obtaining a tax advantage is the main purpose, or one of the main purposes, of the arrangement;[37] and
(b) The arrangement is artificial.[38]

A recent statement by a Welsh government minister confirming the intention to "develop a Welsh tax avoidance rule" suggests that a broader approach, along Scottish lines, will be taken in relation to devolved Welsh taxes.[39]

Administration

Revenue Scotland has been established with responsibility for the devolved Scottish taxes,[40] and an equivalent body for the collection of devolved Welsh taxes is the subject of draft legislation in Wales.[41] The collection and management of SRIT and of NICT will continue to be undertaken by HMRC.[42]

Although separate tax tribunals have also been established to hear cases regarding devolved Scottish taxes,[43] there do not seem to be any plans at present for equivalent Welsh or Northern Irish tribunals.

Endnotes

1 Scotland Act ("**SA**") 1998, s.29; Northern Ireland Act ("**NIA**") 1998, s.6.
2 SA 1998, Sched. 5, para. A1; NIA 1998, Sched. 2, para. 9.
3 Government of Wales Act ("**GOWA**") 2006, s.94 and Sched. 7, para.16A.
4 SA 2012, ss.80I(1) and 80K(1).
5 GOWA 2006, ss.116L and 116N.
6 *See* http://www.parliament.uk/about/how/laws/bills/public/english-votes-for-english-laws/
7 Land and Buildings Transaction Tax (Scotland) Act ("**LBTT(S)A**") 2013.
8 SDLT was disapplied by SA 2012, s.29.
9 LBTT(S)A 2013, Sched. 9.
10 *See* http://www.gov.scot/Resource/0049/00491140.pdf
11 Wales Act ("**WA**") 2014, ss.15 and 16.
12 *See* http://gov.wales/about/cabinet/cabinetstatements/2015/10513231/?lang=en
13 SA 1998, s.73.
14 Finance Act 2014, Sched. 38, amending Income Tax Act ("**ITA**") 2007.
15 ITA 2007, s.6A.
16 *Supra*, note 10.
17 Scotland Bill 2015-16, ss.12–14.
18 WA 2014, s.8.
19 WA 2014, s.12.
20 *See* para. 1.233 at https://www.gov.uk/government/uploads/system/uploads/attachment_data/

file/479749/52229_Blue_Book_PU1865_Web_Accessible.pdf

21 SA 1998, ss.80D *ff*; GOWA 2006, ss.116D *ff*.

22 Corporation Tax (Northern Ireland) Act 2015, s.5.

23 *See* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479116/A_Fresh_Start_-_The_Stormont_Agreement_and_Implementation_Plan_-_Final_Version_20_Nov_2015_for_PDF.pdf

24 Corporation Tax Act ("**CTA**") 2010, Part 8B, Chapter 4.

25 CTA 2010, s.357KE.

26 CTA 2010, Part 8B, Chapter 6.

27 CTA 2010, Part 8B, Chapter 5.

28 CTA 2010, Part 8B, Chapter 7.

29 Recital 7 of Council Directive 2006/112/EC on the common system of value added tax (the "**VAT Directive**").

30 The VAT Directive does provide for a few regional variations in the rate of VAT; for instance, Madeira and the Azores enjoy lower rates of VAT than the rest of Portugal (*cf.* Article 105 of the VAT Directive).

31 Scotland Bill 2015-16, s.16, inserting s.64A into SA 1998.

32 Landfill Tax (Scotland) Act 2014.

33 *See* http://gov.wales/about/cabinet/cabinetstatements/2015/landfildisposaltax/?lang=en

34 Scotland Bill 2015-16, ss.17 and 18.

35 Finance Act 2012, Schedule 23.

36 Revenue Scotland and Tax Powers Act ("**RSTPA**") 2014, s.62.

37 RSTPA 2014, s.63(1).

38 RSTPA 2014, s.62(1).

39 *Supra*, note 33.

40 RSTPA 2014, s.3(1).

41 Tax Collection and Management (Wales) Bill.

42 See http://www.scottish.parliament.uk/S4_PublicAuditCommittee/final_mou_sa.pdf and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/485924/NICT_MoU_FINAL_signed.pdf

43 Tribunals (Scotland) Act 2014; RSTPA 2014, Part 5.