



Pensions and Scottish rates of income tax

The Scottish government has long had the powers to differ the rates and thresholds on income tax for Scottish residents. And from 2018/19 there will be a five tier income tax system for Scottish residents.

Having different rates and thresholds for income tax in different parts of the UK has two important implications for pension schemes and their members. First, pension contributions are entitled to income tax relief, so differently located residents will be entitled to different levels of relief. Second, pension schemes pay their members pension income taxed on a PAYE basis. So, it's important pension schemes can identify Scottish residents.

This factsheet outlines what this difference in income tax structure will mean on a practical basis for Scottish residents paying into a pension scheme or taking a pension income.

Taxing pension income

All Scottish residents are already identified by an 'S' prefix to their tax code. Pension schemes operating a payroll will tax income on an emergency tax basis initially, until HMRC notifies them of the pension scheme member's tax code. They can then tax Scottish residents on the correct tax basis.

Pension schemes operating relief at source

Through various pensions newsletters, HMRC has outlined its approach to how it will treat Scottish residents who are pension scheme members of pensions schemes operating relief at source.

By using the annual return of individual information submitted by scheme administrators by 5 July each year, HMRC will identify pension scheme members resident in Scotland. Each January (starting January 2018) HMRC will electronically send the individual scheme members' residency tax status to pension scheme administrators who are operating relief at source pension schemes. Scottish residents will have an 'S' identifier. Those unmatched will have a 'U'. Everyone else will have a blank field.

HMRC is developing a look-up service for scheme administrators to use for members who join after July each year. If the scheme administrator uses the service:

- between April and December then they will get the member's current tax year residency; or
- between January and April, they also get the residency status for the next tax year. Scheme administrators will be able to use this for the next tax year to give the correct rate of relief at source to members who have joined the scheme since HMRC sent the notification of residency status report in January.

At this point, the current year residency status may be different from the one the scheme administrator has been applying for the current tax year. If so, the HMRC will reconcile this at the end of the tax year, so the member gets the relief at source at the correct rate.

If the scheme administrator is unable to look up the status before they apply tax relief at source to the first contribution, they must default the residency status to the rest of the UK and maintain this rate for the whole tax year. HMRC will sort out any shortfall or excess of tax relief at the end of the tax year.

Changing residency part way through a year

Importantly, once their tax residency status is identified before the start of the tax year, that status is locked in, and even if the person moves part way through the year to somewhere else in the UK, they will retain that residency tax status for the whole of the tax year.

New income tax rates

The Scottish government is introducing a five-tier income tax system for Scottish residents, as well as raising the tax rates for some, and reducing them for others:

Name of band	Band	Rate
Starter	£11,850 - £13,850	19%
Basic	Over £13,850 - £24,000	20%
Intermediate	Over £24,000 - £43,430	21%
Higher	Over £43,430 - £150,000*	41%
Top	Over £150,000*	46%

*The personal allowance is reduced by £1 for every £2 earned over £100,000



Pensions and Scottish rates of income tax

HMRC has confirmed that all pension contributions paid by Scottish residents to pension schemes operating relief at source will continue to automatically receive 20% tax relief paid direct to the scheme. Even though those in the starter band are only paying 19% tax there will be no attempt by HMRC to reclaim any overpayment of tax relief.

Intermediate, higher and top rate taxpayers, however, will have to reclaim any difference in tax relief. They can do this by completing a self-assessment tax return, or intermediate and higher rate taxpayers can contact HMRC direct to ask for an adjustment in their tax code. But will someone earning just over £24,000 be bothered to claim the additional small amount of tax relief?

For a member earning £25,000 a year and paying 5% pension contributions of £1,250 a year the scheme would receive £312.50 direct from HMRC giving a total pension contribution of £1532.50. The member could claim an additional 1% tax relief of £15.63. But the effort to get such a small amount could put them off.

HMRC has announced that although it has put in place this solution for 2018/19, it will continue to work with the industry to develop better solutions for 2019/20 onwards. Hopefully, this may include an automatic adjustment for intermediate taxpayers, rather than asking them to reclaim tax relief.

Welsh government

From April 2019, the National Assembly for Wales will be able to vary the rates of income tax payable by Welsh taxpayers, although it has said no changes will be introduced before 2021. It may be that a similar approach for that adopted for Scottish residents contributing to a pension scheme may have to be rolled out to Welsh pension scheme members as well, if any future changes are made.

If you only read one thing read this:

- Different rates and thresholds on income tax for Scottish residents will have implications for tax relief on pension contributions and the rates at which pension income is taxed.
- Every January HMRC will inform pension schemes of the residency tax status of their pension scheme member (based on information submitted to HMRC in July the previous year).
- HMRC is developing a look-up service for scheme administrators to use for members who join after July each year.
- Once identified, the residency tax status is locked in for the remainder of the tax year, even if the member moves part way through the year to somewhere else in the UK.
- The Scottish government is moving to a five-tier income tax structure. HMRC will continue to pay tax relief direct to the scheme at 20% for all pension contributions. Intermediate, higher and top rate taxpayers will have to reclaim any additional tax relief. This will be a new process for intermediate taxpayers, and some may decide not to reclaim. Starter rate taxpayers (paying 19% tax) will receive slightly too much tax relief.

For more factsheets and product technical support, visit illuminate.nucleusfinancial.com/technical-studio

Scotland, NI and north west England



0131 226 9815

North east and south east



0131 226 9808

Midlands, south west and Wales



0131 226 9804

London and south



0131 226 9801