Finance (No 2) Bill 2025-26: Briefing on income tax rates

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CIOT and ATT submitted briefings on Finance (No 2) Bill 2025-26 clauses 1-8, raising concerns that the new rates for property, savings and dividend income will add significant complexity to an already complex income tax system and highlighting anomalies where devolved tax rates do not match those in the rest of the UK.

The CIOT and ATT have provided briefings for the Committee of Whole House on the first eight clauses of the Finance (No 2) Bill 2025-26.

CIOT's briefing focuses on clauses 4-7 and Schedule 1, which provide for:

- new rates of income tax on property income – increasing the existing rates on property income by 2 percentage points;
- increasing the rates of tax on savings income and dividend income, again by 2 percentage points, except for the dividend additional rate which remains at the

current level of 39.35%;
- a new hierarchy to determine the order in which different types of income are taxed; and
- a new order for the way in which the personal allowance and general reliefs are set off against income.

These changes take effect from April 2027, except for the increase in the tax rates for dividend income, which applies from April 2026. There are multiple consequential amendments arising from the new rates including, for example, provisions that the new property basic rate of 22% will apply to distributions from real estate investment trusts and that the savings basic rate will set the rate for withholding tax on yearly interest.

CIOT's briefing also comments on clause 8 and Schedule 2, which make provision for the devolved governments of Scotland and Wales to set their own property income tax rates in line with their current income tax powers under their fiscal frameworks. These powers will only take effect from a date to be set by HM Treasury by regulation.

Clause 5 will result in different tax rates applying to savings income compared to those applicable to employment and pension income. ATT's first briefing focuses on an unintended practical consequence arising from this measure (see *Collection of tax on savings interest* below).

ATT's second briefing focuses on clause 6, 7 and 8 and Schedule 2 of the Finance Bill, which introduce the changes for income tax on property income, and, in particular, the consequential change to the relief for restricted residential property finance costs, increasing this from the current UK basic rate of 20% to the new UK property basic rate of 22%. As noted above, Schedule 2 extends the devolved powers of the Scottish Parliament and Welsh Senedd to permit them to introduce their own tax rates for rental property income. However, ATT notes that as tax reliefs are not devolved, the new rate of relief for restricted residential property finance costs will apply to both Scottish and Welsh taxpayers regardless of the rates their jurisdictions set.

Complexity

The CIOT's central concern with these changes is the added complexity. The new property rates add five new rates to the existing income tax rates:

- property basic rate: 22%
- property higher rate: 42%
- property additional rate: 47%
- property trust rate: 47%
- savings trust rate: 47%

The number of consequential legislative changes required to effect the new rates for property, savings and dividend income is indicative of this complexity.

A Scottish or Welsh taxpayer is also a UK taxpayer and potentially interacts with UK tax rates as well as Scottish or Welsh tax rates (and bands in Scotland), depending on their sources of income. This creates an additional layer of complexity to navigate (see further below).

In terms of administration, changes will be required, including additions and some redesign of parts of the self-assessment return, tax calculators for quarterly and end of year submissions within Making Tax Digital for income tax, and new forms. Most importantly, timely updated guidance will be needed to allow taxpayers to understand the changes and the consequences for their tax position. CIOT suggested that HMRC will need additional funding to implement these changes.

CIOT recognised that specifying the order of set-off for the personal allowance and general reliefs is to some extent a simplification, as part of the current confusion around tax calculations arises from the ability to allocate deductions in the most beneficial way across all forms of income.

The new savings rates apply to 'savings income' as defined. They will not apply to investment income included in the category of 'miscellaneous income', which will remain subject to the existing income tax rates. While this may reflect the policy intent, CIOT pointed out that the application of different rates to investment returns is a source of complexity for taxpayers.

CIOT noted that there is no explanation of why the dividend additional rate has not changed. It may be that the gap that the rate increases are intended to address (the 'gap between tax paid on work and tax paid on income from assets') is already narrow when taking into account both corporation tax and income tax on dividend

income for an additional rate taxpayer. However, it would be helpful for the government to place on record the reason why the basic and higher dividend rates were changed but not the additional dividend rate.

Collection of tax on savings interest

For PAYE taxpayers who are not in self-assessment, HMRC should be able to collect tax due on bank and building society interest through an adjustment to their PAYE code. Currently, the necessary adjustments are reasonably straightforward because the tax rates applicable to savings income mirror those for non-savings income. For a basic rate taxpayer, £2,000 of savings interest would result in a £1,000 restriction to their PAYE code, having deducted their personal savings allowance. This is reasonably simple to for taxpayers to follow.

Clause 5 increases the savings rates of tax by two percentage points in all tax bands from April 2027. This will result in a mismatch between the rates of tax on savings income and those applicable to the employment and pension income from which any tax due on savings will be collected. In the example above, to collect £220 of savings tax (charged at 22% on £1,000 of savings income), a tax code adjustment of £1,100 will be required, as tax collected via PAYE will be charged at 20%. This £1,100 adjustment will not be readily recognisable to the taxpayer, even if they are aware of the personal savings allowance. The ATT is concerned that this additional complexity will make it harder for taxpayers to check and understand their PAYE codes, creating uncertainty, increasing queries to HMRC and adding to pressures on their customer service staff.

Interaction with taxpayers in Scotland and Wales

The devolved parliaments of Scotland and Wales have the power to set their own rates on all income other than savings and dividends, but do not currently have the power to apply specific rates to different types of taxable income such as property rental income. The Scottish Parliament also has the power to set tax bands for non-savings, non-dividend income.

To date, the Welsh Senedd has not exercised its power to alter tax rates. However, the Scottish Parliament has set its own income tax rates and bands.

Relief for restricted residential property finance costs is currently given at a rate of 20% across the UK, increasing to 22% to align with the new UK property basic rate. A mismatch therefore exists between the rate of relief (22%) and the rates of tax currently paid by Scottish taxpayers (19%, 20% or 21% before paying higher rate tax). This mismatch already exists with the current tax reducer rate of 20% but will come into sharper focus if separate rates of tax on property income are introduced in Scotland and Wales.

The operation and interaction of tax reliefs and reducers depend on the underlying policy intention. In its briefing, CIOT suggested that the government should carry out consultation exercises similar to those in 2012 and 2014, to clarify policy intent in relation to the complicated interaction of these new property rates, which would help ensure that the legislation operates as intended.

The ATT recommended updating relief rules by 2027/28 at the latest, to prevent further inequities when the new property rates and relief rate apply and noted that coordination between Westminster and the devolved administrations will be essential to maintain fairness and clarity.

ATT added that these changes highlight the challenges of managing a tax system within a devolved framework. As powers expand, ensuring consistency becomes more complex.

CIOT's full briefing is available here: www.tax.org.uk/ref1613.

ATT's first briefing is available here: www.att.org.uk/ref505.

ATT's second briefing is available here: www.att.org.uk/ref504.

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