Time to devolve

Management of taxes | Personal tax



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Bill Dodwell asks if it is time to consider devolving income taxes

From 6 April 2017, the historic step of setting different income tax rates and thresholds across the UK takes effect. Those with long memories will recall income tax was briefly invented in 1799, before returning in 1803 in a guise relatively familiar today. Even then, it only took root as a continuous impost when Sir Robert Peel reintroduced it in 1842. We still keep up the witty pretence that income tax is an annual tax.

Calculating income tax in the whole of the UK has become much more complicated, thanks to the savings rate of tax, the personal savings allowance, the dividend allowance and the new higher rates of tax on dividend income. How many of us knew that the law provides that the basic personal allowance may be set against whatever source of income as is most advantageous? Until 2016/17 we had no reason even to think about it.

HMRC have suddenly published a much longer list of exceptions from online filing for 2016/17 – cases where the online calculators fail to give the correct answer. As the notes say, the online calculator can overcharge tax of up to £1,000 and consequently taxpayers and agents are asked to file paper returns and given an extension to 31 January to do so. The underlying problem is the interaction of the personal allowance allocation; the complex rules on the zero rate band of savings income and the additional dividend and savings allowances. These build on the complexity of the High Income Child benefit charge for those with income between £50-60,000; the withdrawal of the personal allowance for those with income between £100-123,000 and the tapering down of the pension allowance for those with income between £150-210,000 (and I've understated exactly how this is done). The challenge for many people is that it's very hard to understand how much tax will be due.

These issues are made even more complicated for Scottish residents – and some face higher taxes.

The Scottish Parliament now sets income tax rates and thresholds for earned income, pensions and property income. Savings income and dividends are taxed under the Westminster schedule of rates and thresholds. Data from the Scottish Parliament Information Centre (SPICe) showed that Scottish residents have lower levels of savings/dividend and property income than the UK average, making up just 4% of total income in 2012/13.

The UK government was keen to retain its control over the personal allowance, given the policy of the Coalition Government to lift it to £10,000 and the current Government's policy to increase it to £12,500. This means that the personal savings allowance and the dividend allowance are also set across the UK and also that the zero band of savings income is a UK-wide creation.

When the idea of a Scottish rate of income tax was first devised, it made good sense to keep savings income outside its remit. For decades, banks and building societies have been required to deduct basic rate income tax (or account for it under the old composite rate scheme) from payments to savers. For many millions of savers that deduction covered their income tax liability. There was an obvious problem should the Scottish government increase or reduce basic rate income tax. Refunding or charging very small amounts would be far too burdensome for HMRC's systems and no doubt wouldn't be very appealing to taxpayers.

It's only as we start in 2017/18 with the new Scottish rates that the new-found horror of the UK-wide system truly becomes apparent.

For example, eligibility to tax-free childcare vouchers depends on an employee's income level. Employers have to estimate the employee's relevant earnings for the tax year since the 'exempt' amount of childcare vouchers is based on their relevant earnings. ITEPA 2003 s 270A sets out the levels of income at which the exempt amount changes. Those references are to the UK-wide thresholds – not to the lower higher rate threshold which now applies to Scottish-resident employees. Another example where the answer has only just become clear with new regulations is annual allowance charges (tax charges where pension savings exceed the allowance). We now know that Scottish thresholds will apply, as well as rates, which perhaps is more expected.

Surely all of us can see that a mishmash of rates, thresholds, allowances and reliefs is hardly a good way to levy the UK's most important tax? People ought to be able to work out how much tax they might pay.

A good place to start would be to hand control over rates for savings and dividend taxation to the Scottish government for Scottish residents. The abolition of interest withholding and the dividend tax credit removes any necessity to keep them under control of the UK government. We might then make anything linked to the higher rate threshold based on the threshold set for where the taxpayer resides.

In 2019, Wales gets the power to set its own rates. Their system is different from Scotland – for no obviously good reason. If it makes sense to devolve part of income tax to Scotland and Wales, surely the only common components should be the base and the personal allowance?