



# Defence Internal Brief

SERIAL: 2018DIB/08

19 Jul 2018

ISSUE: **Scottish Income Tax**

AUDIENCE: **All Service Personnel**

TIMING: **Immediate**

ACTION: **To be briefed for Information Only**

KEY POINTS:

- **Today, 19 July, the Secretary of State announced that financial mitigation payments will be made to those negatively impacted for tax year 2018/19 by Scottish income tax being higher than the rest of the UK.**
- **A single financial mitigation payment will be made retrospectively, in 2019, after the tax year has concluded, and its value will be based upon taxable income earned through military service.**
- **Only Regular personnel (excluding Military Provost Guard Service (MPGS)) who are Scottish taxpayers and negatively impacted by a minimum of £12 for the year, or £1 per month, will be eligible to receive a payment.**
- **There will be a cap on the level of financial mitigation provided, which is set at £1,500. Those who are impacted above the cap will only receive a payment mitigating for the first £1,500 of difference.**
- **All financial mitigation payments made are subject to tax and national insurance deductions when paid. For this reason all payments will be grossed up so that they broadly maintain their intended value once tax and national insurance deductions have been applied.**
- **The Department will continue to monitor the tax difference between Scotland and the rest of the UK and decide on an annual basis whether it is sufficient to warrant retrospective financial mitigation payments, and what minimum impact and cap to apply. As in tax year 2017/18 the Department may decide not to offer mitigation if the impact is low or is restricted to a relatively small number of Service personnel.**
- **More detailed guidance on exactly when these payments will be made and how they will be administered will follow later in the year.**
- **Further information can be found below and a Q&A brief is at Annex A.**

DETAIL:

## Introduction

1. On 12 March 2018, the Secretary of State [announced via the Defence Intranet](#) that “he [was] looking to counter the Scottish Government’s income tax rise that affects thousands of Armed Forces personnel in Scotland.” The work he commissioned (see [2018DIB/02 dated 12 Mar 18](#)) has now concluded and this DIB outlines the way forward for Tax Year (TY) 2018/19 and beyond.

## Background

2. As part of the wider devolution settlement for Scotland, the Scottish Government (SG) has, from last tax year (TY 2017/18) onwards, been given greater devolved Income Tax setting powers. These allow them to set Income Tax rates and individual rate threshold levels in Scotland independently from the remainder of the UK (rUK). Their current powers are detailed in the Scotland Act 2016 and no employee group, including the Armed Forces, is exempt from being treated as Scottish taxpayers where they meet the relevant criteria.

3. Whether a SP is considered a Scottish taxpayer or not is determined by where they live, not where they serve, and – more specifically – where their ‘main place of residence’ is, as defined within the legislation. More detailed guidance on Scottish Income Tax (SIT) and the criteria for being a Scottish taxpayer can be found in [DIN 2018DIN01-037: Scottish Rates of Income Tax](#).

4. In TY 2017/18, where the impact was restricted to a relatively small number of SP it was decided that no form of mitigation would be needed. However, for TY 2018/19, following significant change in the tax rates and thresholds for Scotland, it was recognised that the impact on SP is much greater and many more are affected. It was therefore decided that options to mitigate the impact of the tax changes should be introduced to help ensure that affected SP did not feel disadvantaged by their service.

5. In broad terms, Scottish taxpayers are affected in TY 2018/19 in the following way:

- a. Where annual taxable earnings are less than £26K then individuals will pay less Income Tax over the year (up to £20 p.a.) than their rUK counterparts; and
- b. Where annual taxable earnings are more than £26K then individuals will pay more than their rUK counterparts, with the amount of difference increasing the more they earn.

## Mitigation Payment Policy

6. Review Findings. The differential tax position in Scotland compared to rUK, and its impact on SP, arises from wider Government decisions to devolve income tax-setting powers and not to provide any sort of exemption for members of the Armed Forces. As part of this policy review the MOD revisited the reasoning behind these decisions, in particular the latter not to exempt SP from the impact of devolved income tax. It has been reconfirmed with Other Government Departments that the benefits of all those living in a Devolved Administration paying taxes levied there continue to outweigh other arguments for treating the Armed Forces differently from other taxpayers.

7. Given this, legislative change cannot be justified as a means of avoiding the consequences of devolved income tax and so, where SP meet the criteria, they must continue to be taxed as Scottish taxpayers. Numerous options were investigated but due to administrative complexities the only viable approach was to make a retrospective payment, after the end of the tax year, once it is known how much has been earned and so what the total impact is. Such an approach would also allow for the in-year changes to taxpayer status where SP can change from being a Scottish to a rUK taxpayer, or vice versa, at any time during the year as circumstances change.

8. No other public sector workforce is being offered financial mitigation as a result of living in Scotland and so subject to higher income tax. Wider Government approval to offer mitigation to the Armed Forces is based upon the argument that SP do not choose where they serve and so cannot avoid higher taxation in particular parts of the UK by, for example, moving away. This argument applies most directly to Regular SP (excluding MPGS who choose to work in a particular region) and so financial mitigation for devolved income will only apply to Regular SP (excluding MPGS). For the same reasons mitigation **cannot** be offered to those engaged on Full Time Reserve Service (FTRS) or serving in the Part-Time Volunteer Reserve (PTVR).

9. Policy Approach. Financial mitigation will only be provided for earnings associated with Regular military service as detailed in the annual P60 return published by DBS in May each year. Other earnings, e.g. from investments or rental property, or earnings from other household members (e.g. spousal income) are out of scope for mitigation. Similarly, any negative impact experienced through other forms of taxation (e.g. higher Pension Annual Allowance tax charges being applied) are also out of scope.

10. Where a financial mitigation payment is made, it will only be where the SP is impacted above a minimum level (the 'floor'). In addition, the amount of mitigation provided will be capped at a maximum level (the 'cap'). For TY 2018/19 the floor will be set £12 p.a, or £1 a month, and the cap will be set at £1,500 p.a.

11. HM Revenue and Customs (HMRC) have determined that all financial mitigation payments made to SP will be treated as additional taxable income. Therefore, in order to give individual SP a payment of a particular value it will

need to be grossed up so that once tax and national insurance deductions have been applied it will be approximate to its intended value. This provides an additional level of complexity as each SP can potentially have different tax arrangements which are reflected in their tax codes.

12. In order to deliver something which can both be easily understood and delivered accurately via the payroll, for the purposes of calculating the mitigation payment only, it is necessary to apply the following pragmatic assumptions:

- a. That the total annual taxable income of the SP in the year that the mitigation payment is made is the same as in the previous year – this allows us to determine a marginal tax and national insurance rate to apply when grossing up based upon an estimate of taxable earnings for the year that the payment is made.
- b. That the SP is still a Scottish taxpayer in the year that the mitigation payment is made – this allows us to apply a single tax rate when grossing up which matches the rate which would have applied had the payment been made in the same tax year that the difference in tax occurred.
- c. That the SP has a normal tax position and so tax is being applied in the normal way, e.g. all of their personal allowance is available in the year that Scottish tax was applied and also in the year that the mitigation payment is being made – this allows us to determine the tax difference for all based upon a normal example.

13. Work is still continuing to build the necessary functionality into JPA, and more information on the process will be published later this year. However, the intent is that payments will be calculated and made centrally without the need for any SP input, using data already collated annually for [the P60 process](#) in May each year. We expect retrospective financial mitigation payments for Tax Year 2018-19 will be paid alongside salary in either June or July 2019.

14. As an example, where a Scottish taxpayer SP has a taxable income in Tax Year 2018/19 of £52,000 reported in their P60, then the difference in tax paid will have been £844. Assuming the same taxable income in Tax Year 2019/20, when the mitigation payment is made, that £844 will need to be increased so that when 41% income tax and 2% national insurance are both deducted then the SP receives £844. In this case a grossed up payment of £1,480.70 will, after deductions, give the SP £844 in additional take home income.

15. Once a mitigation payment has been made it will, in the TY that it is paid, inflate the taxable earnings of that SP. For the vast majority, this will not be a problem. However, SP will need to be aware that where their entitlement for benefits or tax credits is linked to taxable income then the act of providing financial mitigation may impact on such entitlements. Where the SP judges that it is in their best interests not to receive any financial mitigation then a

process will be made available for the individual to have that transaction reversed, i.e. to pay the money back.

16. Financial mitigation is only agreed for TY 2018/19. Looking forward, it is recognised that tax rates and thresholds will change every year. Therefore, from Tax Year 2019/20 onwards, there will be a review undertaken annually and, based on the tax differential and the numbers of personnel negatively affected, a decision made as to whether to provide financial mitigation and, if so, between what floor and cap. The aim is to announce the decision, whether to mitigate or not, as soon as possible after tax rates and thresholds have been agreed/ratified by the relevant Governments/Parliaments.

**SUBJECT CONTACT:** Armed Forces Remuneration Pay Policy Team Tel: 9621 78293

**FURTHER INFORMATION:** More information about being a Scottish taxpayer is available at: [DIN 2018DIN01-037: Scottish Rates of Income Tax](#)

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For past DIBs see: <http://defenceintranet.diif.r.mil.uk/Reference/Briefs/DIBS/Pages/DIBsHome.aspx>

**QUESTIONS AND ANSWERS**

**Q. How do I claim my financial mitigation payment?**

A. More detailed guidance will be published later this year, but the expectation is that no-one will need to claim. We hope to use data already collated after the end of the Tax Year, for the production of annual P60 tax statements, to determine who is eligible (i.e. was a Scottish taxpayer) and for how big of a payment (i.e. total taxable earnings). P60s are usually produced and sent out in May; we would hope to be able to make retrospective financial mitigation payments for Tax Year 2018/19 as part of the June or July 18 pay runs.

**Q. Why are only Regular personnel eligible? Why are Military Provost Guard Service (MPGS) and Reserves not eligible?**

A. The only reason why the Government is allowing payments of this kind to be made is because of the argument that Service Personnel do not have a choice of where they serve, and so by extension where they live. So, unlike others, they cannot choose to move away in order to avoid paying higher rates of income tax levied in specific parts of the UK. To varying degrees non-Regular personnel – Part-Time Volunteer Reserves, those on Full-Time Reserve Service assignments, and members of the Military Provost Guard Service – have all applied to work in the specific locations where they serve. It therefore cannot be claimed that their experience is sufficiently different from other employees who choose to work and live where they do.

**Q. Why is there a floor and cap being applied to the financial mitigation being provided? And why is this being reviewed annually?**

A. Whilst MOD does try to reduce the amount of financial difference experienced by members of the Armed Forces through service in different locations, e.g. through Contributions in Lieu of Council Tax for service accommodation instead of paying local council tax, there is no legal basis for doing so. For devolved income tax we have weighed up the impact on those SP affected and assessed the degree to which SP might legitimately feel disadvantaged by their service through the payment of higher tax in one location over another. For Tax Year 2017/18 we judged the impact to such that no financial mitigation would be required. For Tax Year 2018/19 the changes made by the Scottish Government significantly increased the impact and so it was judged that some form of mitigation should be offered. The floor and cap approach is deemed necessary to restrict the amount of mitigation provided to the degree necessary to manage morale, and so also retention.

**Q. If I do not want or need a mitigation payment can I opt out?**

A. No, but there will be a process for paying it back if you wish to do so.

The following Q&A have been copied from [DIN 2018DIN01-037](#) for ease of reference and annotated where necessary.

**Q. Am I a Scottish taxpayer?**

A. You are a Scottish taxpayer if you meet the criteria laid down by HMRC, i.e. if your main place of residence in any tax year is in Scotland. Annex A [of [DIN 2018DIN01-037](#)] provides some worked examples of how some SP may be a Scottish taxpayer whereas others may not. The flowchart at Annex B [of [DIN 2018DIN01-037](#)] may also be helpful, as well as the more detailed guidance in the main text of this DIN. If HMRC have already identified you as a Scottish taxpayer you will already have a Scottish tax code with an S suffix (e.g. S1185L).

**Q. I have Scottish tax code but I do not think I am a Scottish taxpayer. What should I do?**

A. If you believe that you have been wrongly identified as a Scottish taxpayer then you should contact HMRC and have the error corrected. Details on how to do this are on the last (Change of Circumstances) section of Annex A [of [DIN 2018DIN01-037](#)].

**Q. I do not have Scottish tax code but I think I am a Scottish taxpayer. What should I do?**

A. If you believe that you have been wrongly identified as a UK taxpayer then you should contact HMRC and have the error corrected. Details on how to do this are on the last (Change of Circumstances) section of Annex A [of [DIN 2018DIN01-037](#)].

**Q. Why is it not possible for MOD to simply apply UK income tax to all SP at source rather than have the difficulty of trying to seek to compensate SP separately after the fact?**

A. The law requires HMRC to issue Scottish tax codes to those SP who meet the criteria of being a Scottish taxpayer, and the law requires MOD to deduct income tax through 'Pay As You Earn' arrangements in strict accordance with the tax codes issued by HMRC for each individual employee. Without a change in the law MOD cannot simply ignore Scottish income tax and apply UK income tax to all.

**Q. Council tax levied on SP in Service accommodation is harmonised so that SP pay the same wherever they live in the UK. Why can't the same approach be adopted for income tax?**

A. As explained in the last answer above, the law dictates what can and cannot be achieved. For Service accommodation (but not private accommodation owned or rented by SP) there is a longstanding exemption from council tax within the relevant regulations which allows MOD to instead

calculate and levy through the payroll a separate Contribution in Lieu of Council Tax (CILOCT) daily charge.

**Q. Why should SP pay higher rates of income tax in one part of the UK compared to another?**

A. The decision to devolve powers to the individual countries which make up the United Kingdom, and to introduce devolved administrations in Scotland, Wales and Northern Ireland, has been the policy of successive governments. As part of that process greater powers have been introduced over time and it has been widely recognised that political accountability locally is best served when local politicians are responsible for setting taxation rates as well as spending any monies collected on local services. SP and their families, as users of local services, should, like other taxpayers in the community, be able to hold their local politicians to account for the decisions they make which affects them. The MOD supports the devolution of further powers to Scotland and other devolved nations; whilst Defence remains a reserved matter, income tax is not and has been devolved.

**Q. I live in Wales; can I expect to pay different rates of income tax here soon?**

A. Recent legislation has devolved new income tax setting powers to the Welsh Government with effect from TY 19/20. These powers are not as extensive as those devolved to the Scottish Government and the [Welsh Government website](#) states that they are “committed not to increase income tax rates in Wales for the duration of the current Assembly, which is due to continue until May 2021”.

**[Note: If and when the Welsh Government decide to set Welsh Income Tax differently from the rest of the UK then the same financial mitigation payment policy will be applied as is now being introduced for Scottish Income Tax]**

**Q. I live in Northern Ireland; can I expect to pay different rates of income tax here soon?**

A. There are currently no income tax setting powers devolved to the Northern Ireland government.

**Q. If I serve overseas I can claim Local Overseas Allowance (LOA) to compensate for the additional cost of living associated with being resident there. Why is the same consideration not given to service in a devolved Scotland where the cost of living through additional taxation is now different?**

A. LOA aims to provide a contribution towards the necessary additional local cost of day-to-day living to those living and serving in overseas locations. LOA does not cover local taxes as all UK Crown servants are required by law to pay UK rates of income tax when serving/working abroad on UK Government business. Up until recently there has only been one type of UK income tax. However, under devolution there are now two type of UK taxation

Scottish and the remainder of the UK), and, from tax year 2019/20, there will be three types once powers devolved to the Welsh Government take effect. Should it be judged necessary to make a similar contribution towards the additional cost of paying Scottish (or in future Welsh) rates of income tax then this will be decided and communicated to the workforce on a year-by-year basis.

**[Note: This DIN serves as that notification for Tax Year 2018/19]**