

HM Treasury consultation

Breathing space: call for evidence

Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

- 1.1 As tax professionals with many years' experience assisting low-income taxpayers, we welcome the opportunity to contribute to this call for evidence in relation to a 'breathing space' scheme for those with problem debt. In the area of debt, our expertise is in relation to tax and tax credit debts only, and our comments below are based on this specialist knowledge. These debts are of course the responsibility of HM Revenue & Customs (HMRC) and so are government debt.
- 1.2 It should be borne in mind that tax and tax credit debt are unusual in the debt field because often the debt itself can be inaccurate, usually due to a lack of communication between HMRC and the debtor over a relatively long period of time, perhaps as a consequence of a life event which has caused the debtor to be unable to deal with matters such as tax or tax credits – or indeed through inaccurate calculation of the debt by HMRC in the first place. Therefore debt advice in this context will involve checking that the debt is correctly due (or most often liaising with HMRC to arrive at the correct amount of debt, or agreeing there is no debt at all) as well as advice regarding how to manage payment of any agreed debt.
- 1.3 We believe there should be a consistent approach to collecting government debt from all government departments which should be published as a formal 'Code of Practice' and be publicly available. This should specifically cover the treatment of vulnerable customers.
- 1.4 We are concerned that a six-week breathing space may not be sufficient time to make substantial progress in managing debt, in particular tax and tax credit debt. Therefore there must be clarity around what can be expected to be achieved in the breathing space period and what the next steps should be once the breathing space has ended.

- 1.5 Regardless of any eligibility criteria that may be prescribed, we think provision should also be made for discretion to be exercised as to entitlement to breathing space in appropriate cases, as our experience of the breadth of circumstances that can give rise to indebtedness and default suggests that it would be impossible to create criteria which covers all relevant outcomes.
- 1.6 A breathing space period should only be available to those genuinely in financial difficulties who need support to deal with their debts and not the minority of debtors who have the means to pay but who choose not to. The challenge is to be able to distinguish between the two.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 General comments

- 3.1 Tax and tax credit debt are atypical forms of debt because often the debt itself can be inaccurate, usually due to a lack of communication between HMRC and the debtor over a relatively long period of time, perhaps as a consequence of a life event which has caused the debtor to be unable to deal with matters such as tax or tax credits. It is also not uncommon for the debt itself to be incorrectly calculated by HMRC in the first place: we have even seen cases in which the sums allegedly owing in tax due or tax credits overpaid have, when other matters are taken into account (payments made on account, reliefs or allowances due, additional credits or exemptions claimable), turned out to be much smaller than stated, or even sums properly due from HMRC to the taxpayer. Therefore debt advice in this context will involve checking that the debt is correctly due (or most often liaising with HMRC to

arrive at the correct amount of debt, or agreeing there is no debt at all) as well as advice regarding how to manage payment of any agreed debt.

- 3.2 It should be noted that tax credit debt can arise without any 'fault' from the taxpayer. This is due to the way the tax credit system operates by initially basing payments on the income of the previous year, for example a 2017/18 claim is based on the income of 2016/17. In these times of more variable income due to the increase in non-standard work such as the gig economy, agency workers, and zero hours contract work, this can give rise to unexpected debt when the tax credit award is finalised after the end of the tax year to which it relates.
- 3.3 The collection of tax debt, being public debt, is not governed by the Financial Conduct Authority's (FCA) rules which apply to commercial creditors. The FCA's rules require, amongst other things, that customers are treated fairly and that creditors show forbearance where there is evidence that a client is in financial difficulty. There needs to be a similar consistent approach from all government departments to collecting government debt which should be made into a formal 'Code of Practice' and be publicly available.
- 3.4 From our experience of dealing with tax and tax credit debt, we know there is an inconsistent approach to debt management within HMRC. Some debts can be pursued with vigour when they have only been outstanding for a short period, while others can be left for months if not years before any action is taken to collect them, by which time the debt is often much larger than when it first arose (for example, as a consequence of penalties being charged in the intervening period, and interest charges). Such inconsistency of treatment is unhelpful to maintaining public funds and is unfair to debtors. It also makes the job of a debt adviser much more difficult when trying to help a client with a debt management plan. This is because HMRC's collection and enforcement actions in respect of a tax or tax credit debt often cannot be foreseen, unlike many other creditors who must comply with the FCA rules or risk being sanctioned.
- 3.5 A Code of Practice should specifically cover the treatment of vulnerable customers who have debts, and should be referenced in Your Charter, published by HMRC.
- 3.6 We are pleased that the provision of readily available debt advice remains a government priority. While we welcome the recent decision to create one body to deliver free debt advice if it ensures more people can access help as the Government predicts, it is very important that generalist debt advisers are aware that tax and tax credit debt may need a two-pronged approach such as that described above and that resources are made available for specialist training to raise their awareness of the key issues that commonly arise. Additional funding should also be made available to the specialist tax charities, TaxAid and Tax Help for Older People, who regularly advise their clients on tax debt and to whom other debt advice-giving organisations are apt to refer their own clients experiencing tax debt.
- 3.7 We note that the proposed breathing space which is the subject of this call for evidence is intended to be for a six-week period. We are concerned that in many cases involving tax or tax credit debt, this period will be too short to achieve anything effective in terms of debt management, particularly if action has to be taken to establish the correct amount of the

debt in the first instance. It can often take several weeks to get an appointment to see a debt adviser, whether that is with a specialist charity like TaxAid or Tax Help for Older People or with other charities such as Citizens Advice, and can then take many more weeks or even months to reach agreement on both the amount due and an acceptable debt management plan, particularly if there are multiple debts.

- 3.8 Therefore it needs to be clear to the debtor considering whether to participate in a breathing space arrangement what is expected of them by the end of the six-week period. Paragraph 2.8 of the consultation says that someone coming out of a breathing space period 'would be entering, or working towards entering, a future plan for dealing with their debts'. So is it the intention that the debtor would have to show they were taking steps towards managing/repaying their debt? Or would they have to commit themselves to a statutory debt repayment plan? There must be clarity around what can realistically be expected to be achieved in a six-week period and what the next steps must be once the breathing space has ended for the proposal to be attractive to debtors, and thereby be useful as a debt management tool. There must also be clear communications for all involved.
- 3.9 We have addressed below the questions listed in the call for evidence document where we believe we have some relevant comments.

**4 Q1: In your opinion, how should government decide who is eligible for a breathing space?
Q2: What should be the trigger point for starting a breathing space?**

- 4.1 If Government policy is to encourage people to seek debt advice earlier and it is anticipated that the breathing space process is to be an important part of debt management then any criteria for eligibility should be relatively easy to meet, and easy to understand. But setting general criteria which will apply across the board may be difficult when different creditors operate in different ways.
- 4.2 With regard to tax debts, HMRC will usually allow taxpayers the opportunity to repay debts over a period of time based on their means to pay if they contact them and request a time-to-pay (TTP) arrangement. At this stage, interest is being incurred on late payment, but any late payment penalties which can legally be charged will usually be waived if a TTP arrangement is in place. Although the terms of TTP arrangements eventually agreed by HMRC can vary significantly between taxpayers, it seems it is a reasonable approach to take where debtors seek to engage with HMRC to manage the debt themselves. If taxpayers then default on their TTP arrangement, HMRC will tend to move to enforcement action. In order to balance the needs of the public purse with the need to offer support to those in debt, it may be most appropriate to offer breathing space to those debtors at this stage, i.e. those who have defaulted on an informal TTP arrangement, if it steers them into a more formal yet still manageable arrangement. Although the public purse will forego interest in these circumstances, hopefully costs of enforcement action are avoided.

- 4.3 There are other types of debtor: those who ignore the debt until enforcement action is taken because they want to put off payment as long as possible, even though they have the means to pay; those who do not have the means to pay and therefore put off dealing with the debt through fright; and those who are genuinely unaware that they are in debt until HMRC start pressing for payment. The latter two types of debtor may be in default by reason of vulnerability or incapacity which is unknown to HMRC, or through not knowing how to proceed or where to get help, or not being able to afford substantial repayments. However if they were eligible for breathing space at the enforcement stage when they can no longer ignore the debt, this may encourage some debtors to get the debt checked and to negotiate a repayment plan. This in turn may achieve earlier constructive engagement than would otherwise be the case.
- 4.4 It should be noted that currently HMRC's Needs Enhanced Support (NES) service should support vulnerable customers who fall into these categories, however accessing the NES service can be difficult if the debtor does not have assistance from a charity or voluntary sector adviser.
- 4.5 Whether similar steps are taken in the private sector when debts occur is not known, but it may be that it is necessary to have different criteria depending on whether it is a public or a private debt.
- 4.6 Often those with debts have multiple debts rather than single debts. Where this is the case it may not be straightforward to identify eligibility criteria as the individual may be at different stages of the debt collection process for different debts and so it may also be necessary to have different eligibility criteria depending on whether it is an individual with single or multiple debts.
- 4.7 Regardless of any eligibility criteria that may be prescribed, we believe provision should also be made for discretion to be exercised as to entitlement to breathing space in appropriate cases, as our experience of the breadth of circumstances that can give rise to indebtedness and default suggests that it would be impossible to create criteria which cover all relevant outcomes.

5 Q3: Should all debts be eligible for a breathing space?

- 5.1 Yes, if the purpose of the breathing space period is to ease the pressure on the debtor for a short period to allow time to plan how to overcome the indebtedness, then all debts should be part of a breathing space arrangement. Further, all debtors should be able to take advantage of this except in very exceptional cases, for example where it is clear there are funds available to settle the debts but the debtor is choosing not to pay.
- 5.2 Any debts owed by self-employed micro businesses should definitely be included in a breathing space period as these are personal debts. If some debts are exempt or excluded then this could introduce unnecessary complexity into an already stressful situation for many. We would not advocate exempting the late payment of penalties from a breathing

space – there are many penalties issued by HMRC for late payment which prove to be successfully appealed or erroneously charged on closer examination of the facts and so cancelled.

6 Q4: Should all interest, fees and charges be frozen throughout the breathing space period?

6.1 If the debtor is suffering financial difficulties and is barely managing to pay their debts, continually adding interest, fees and charges to any outstanding amounts so that the debts continue to grow can substantially increase the pressure felt by debtors, and in some cases decrease the inclination to tackle the underlying debt itself. Therefore in our view it would be of greater benefit to the debtor if all interest, fees and charges were frozen throughout the breathing space period.

7 Q5: What activities must the breathing space participant continue with to remain eligible?

7.1 If the purpose of the breathing space period is to allow time to plan how to manage the debt, this can often be done by negotiation directly with the creditor if it is a single debt. However if there are multiple debts it is more likely to be beneficial to seek advice from a specialist adviser who can identify priority debts, plan repayments, etc. Therefore it would not seem appropriate to compel debtors to attend advice sessions during this period as it may not always be beneficial for them in their particular circumstances and it would use up an adviser's valuable time unnecessarily. Alternative methods of support could be made available such as online guidance, helpline, etc., which may be cheaper to provide and more effective.

7.2 It could be helpful to offer opportunities to make voluntary payments during the six-week period if a debtor's financial circumstances meant they could afford to do so, but it should not be a requirement of the breathing space period to do so.

8 Q6: Are there circumstances in which a breathing space period could end before 6 weeks, such as if an appropriate solution is found? Who could be responsible for enforcing this?

8.1 In our view, this will depend on the appropriate solution that is identified. If a debtor wants to end the breathing space period early, for example if funds to clear their debts in full became available, perhaps by way of a family loan, then they should be allowed to do so without penalty. However we cannot see the benefit of ending the six-week period early if a suitable debt management plan is agreed before the expiry of the breathing space. If this were to be the case, it could act as a disincentive to make quick progress towards reaching such an agreement!

9 Q7: Should breathing space protections only cover debts existing at the outset, or also include new debts arising during the 6 week period?

9.1 If a debtor is eligible for a breathing space in respect of a debt and the necessary criteria are fulfilled, then another debt comes along during the breathing space, that subsequent debt should be tested against the same criteria as the earlier debt to judge whether it too is eligible for a breathing space. If so, the breathing space applicable to the subsequent debt should be allowed to run its full course.

10 Q8: Should a breathing space be noted on a person's credit file?

10.1 If accepting a breathing space period to review and organise debts was to be included on a credit history which is checked for referencing purposes then this might discourage individuals from taking them up, particularly those who otherwise have a 'clean' credit record and may have short-term debt issues. If defaulted on and subjected to enforcement procedures, the debt will in any case appear on the debtor's credit record if judgment is entered against the debtor.

11 Q9: How frequently should a debtor be able to access a breathing space, and what criteria should control the frequency of access?

11.1 We would urge caution when considering whether to limit access to a breathing space period. It is not uncommon for taxpayers to have more than one TTP arrangement over their taxpaying lifetime, and for those who repeatedly find themselves in a debt spiral, help is usually needed, by way of both debt advice and financial education.

**12 Q10: What challenges would creditors face in implementing the scheme?
Q11: Who would be responsible for notifying creditors that a customer has entered a breathing space? What updates are required during a breathing space period?**

12.1 Where an individual has multiple debts then it would be very difficult for a single creditor to implement a breathing space period and so in these circumstances a debt administrator would almost certainly be needed. They would notify all creditors and provide updates as required. There may be issues of confidentiality to be addressed with such an arrangement as a debtor may not want all their creditors to be aware of the full extent of their indebtedness.

12.2 However it should be possible and manageable to apply a breathing space period to a single particular debt by the creditor to whom the debt is owed provided the process is straightforward and clear. They should be able to factor it into their standard debt management/collection procedures. For example, they could automatically apply a breathing space after, say, two missed payments.

13 Q12: Would a breathing space scheme impact on business revenue or have any other significant detriment?

13.1 No comment.

14 Q13: Should any creditor be exempt due to the size of their business?

14.1 No comment.

15 Q14: What benefits could creditors see as a result of a statutory breathing space scheme?

15.1 If the scheme is successful, creditors should see problem debts being managed more effectively and so a better recovery rate of bad debts overall. Where the breathing space arrangement leads to a more stable repayment of debts, even if over a longer period, that stability will benefit the creditor as well as the debtor.

16 Q15: How could the government ensure that a breathing space works with and adds value to existing support structures?

16.1 We would like it to be compulsory for creditors to offer a breathing space period to debtors as a tool in their debt management process. However it is rare that a 'one size fits all' approach works when it comes to debt management and therefore the breathing space scheme should be a voluntary option for those individuals who meet the eligibility criteria.

16.2 Consideration should also be given to imposing sanctions on any creditors that continue to take debt collection action during a breathing space period, and so breach the arrangement.

17 Q16 to Q23 – no comment

18 Q24: Should the repayment plan apply to all debt?

Q25: For the included debts, should some debts be prioritised for repayment?

18.1 Yes, it is more beneficial to the debtor to include all debt in a repayment plan, to give peace of mind. Debts currently treated as priority debts should continue to be treated as such under a statutory debt management plan.

19 Q26: What should happen if one or more creditors disagree with the plan?

19.1 It would be disappointing if minority creditors were able to force the breathing space option to be abandoned.

**20 Q27: What activities must the statutory debt repayment plan participant continue with to remain eligible? Must they simply meet agreed repayments to remain eligible?
Q28: How should changes in income be dealt with? Should it be possible to suspend a plan or have reduced payments for a period of time?**

20.1 Provided agreed repayments are made, then the debtor should be allowed to remain within the scheme. Any substantial change in income or circumstances should mean that the terms of the statutory debt repayment plan are revisited with a view to recalculating repayment based on the change in income.

20.2 Consideration needs to be given to how 'income' is defined in this situation (for example, is it annual income, monthly income, earned income, windfalls, etc.?) and also who can instigate a review. Should it be either the debtor or a creditor? A change in circumstances leading to a drop in income should perhaps allow a debtor to request a review of any debt management plan. Similarly, perhaps a creditor should be allowed to request a review where there has been an apparent increase in income? If the creditor were to have rights to request a review then the debtor would need to be regularly reporting their income during the period of the statutory debt management plan otherwise the creditor would not know about any change in income. This in turn increases the administration burden – and therefore the cost of such a scheme.

21 Q29: What happens if a plan fails? Should creditors be able to apply any interest, fees or charges that they were prevented from charging during the plan?

21.1 No.

LITRG
16 January 2018