

**HM Treasury consultation on a policy proposal
Breathing space scheme
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 respond to this consultation in relation to a 'breathing space' scheme for those with problem debt. This follows our submission to the call for evidence in January 2018.¹ 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)² and so are government debt.
- 1.2 It should be borne in mind that tax and tax credit debts are unique in the debt field because often the quantum of 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 become unable to deal with matters such as tax or tax credits. 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 <https://www.litrg.org.uk/latest-news/submissions/180117-breathing-space-call-evidence>

² In tax credits terms, to the extent that they have not been transferred to the DWP. See <https://revenuebenefits.org.uk/universal-credit/guidance/existing-tax-credit-claimants/tax-credit-debt>

- 1.3 We support the Government in taking forward its 2017 manifesto commitment to implement a breathing space scheme and statutory debt repayment plan. We understand from the consultation document that tax and tax credits debts are within the scope of both breathing space and the statutory debt repayment plan (as they are not listed as excluded debts), and indeed we would stress that it is right that they should be. However, even at this stage of the consultation working towards implementation of these proposals, we are still not clear as to how the proposals will work in terms of tax and tax credits debt.
- 1.4 We would therefore welcome further clarification of the issues raised in this paper, with a view to ensuring that:
- Debtors are not signed up to payment plans that include tax or tax credits debts without expert consideration of whether the liabilities are actually due;
 - Such expert advice on tax and tax credits debts is available to all and free to access, with extra funding made available to voluntary organisations to fill the gaps as necessary;
 - HMRC have identified whether any changes in primary tax legislation are required (for example so that the new schemes are recognised as formal arrangements such that further tax late payment penalties are prevented from arising);
 - Consideration is given to what we might term ‘mixed’ HMRC liabilities – for example, student loan repayments that are wrapped up within a total Self Assessment tax liability, given that it is proposed that student loans are excluded from the new schemes;
 - National Insurance contributions are treated as a priority debt where unpaid amounts might result in the individual not contributing enough to make a ‘qualifying year’ for benefits purposes (including state pension accrual);
 - It is made clear how these new provisions will sit alongside existing debt practices, for example HMRC’s ability to engage with a taxpayer and agree ‘time to pay’, and also how individuals will find out about the schemes and their application to HMRC debt;
 - Full guidance is published as to how the schemes apply to HMRC debt.
- 1.5 We would stress that the above issues are surmountable and that tax and tax credits debts should not be excluded from the new schemes. We are happy to meet to discuss further any of the points raised in this response, to help with the development of workable schemes.

2 About us and general comments on this consultation

2.1 About us

- 2.1.1 The 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.

- 2.1.2 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.
- 2.1.3 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.

2.2 ***General comments on this consultation***

- 2.2.1 Our interest in this consultation is largely confined to our experience with individuals who are in debt to HMRC, due to tax having been underpaid or tax credits overpaid.
- 2.2.2 We welcome moves to introduce alternative means of debt management and we are pleased to note that tax and tax credits debts are not on the lists¹ of debts excluded from both schemes' protections. However, we are concerned that thought still needs to be given to how such schemes interact with tax legislation, and indeed with HMRC practice.
- 2.2.3 We discuss some of these issues below, and wish to highlight that it will be necessary for creditors such as HMRC to highlight the existence of these new schemes to taxpayers. For example, HMRC have a Needs Enhanced Support (NES) service aimed at vulnerable taxpayers. These HMRC officers are therefore likely to encounter people with problem debt, who need to be directed to sources of debt advice and informed how they might obtain 'breathing space' in terms of dealing with their tax debt. It is unclear to us how the existence of these new provisions will fit alongside existing practice, such as HMRC's ability to engage with a taxpayer in debt by allowing 'time to pay'.
- 2.2.4 We believe, however, that all the issues we raise in terms of the schemes' interactions with tax and tax credits debts are surmountable, so we would not wish to see them added to the excluded debts lists. Indeed, we would be pleased to work with developers of the two schemes to help address these points.

¹ That is, the lists found within sections 4.2 and 7.1 of the consultation document.

3 Response to consultation questions on breathing space

3.1 Eligibility criteria for breathing space scheme (Questions 1-4)

Question 1 – Do you agree with the eligibility criteria for entering breathing space, including the 12 month limit?

- 3.1.1 We broadly agree with the proposed eligibility criteria for the breathing space scheme. However, it is important that when a debtor accesses debt advice, the adviser has either the specialist knowledge that would enable them to help resolve any queries that may arise around the quantum of the debt itself or can obtain support quickly with this from other agencies.
- 3.1.2 This is particularly relevant when dealing with tax and tax credits debts. This is because in many such debt cases it is necessary to have a good understanding of some technical tax or tax credit areas to be able to assess the accuracy of the amount of the debt in the first instance. It is very common for tax (and in some cases tax credits) debt to be substantially reduced or even extinguished completely following a challenge to HMRC on technical grounds.
- 3.1.3 We note that it is expected that organisations from both the free-to-client and commercial debt advice sectors would be able to offer access to breathing space. In the interests of transparency, we recommend that commercial debt advisers who offer access to breathing space are required to clearly publicise their charges for undertaking such work. Ideally there should be a fixed-fee structure chargeable by all such advisers so it is clear to the debtor what charges they will incur if they use a commercial provider for debt advice.
- 3.1.4 If one of the objectives of the scheme is to attract more of the one-in-six people in the UK who are over-indebted¹ to come forward for help to manage their situation, the free-to-client services must be properly funded to deal with the increased demand for their services.
- 3.1.5 The debt advisers who will be expected to make the eligibility assessments will need good quality guidance and training for their role. Given the specialist nature of tax debt, the public-facing tax charities (TaxAid² and Tax Help for Older People³) are perhaps best placed to review whether a tax debt for a low-income taxpayer is correct, so ideally they would work with generalist debt advisers on individual cases. However, the additional work this would cause them would also need to be appropriately funded.

¹ See, for example, 'A picture of over-indebtedness', Money Advice Service, March 2016: https://masassets.blob.core.windows.net/cms/files/000/000/347/original/MAS_Report_A_picture_of_overindebtedness.pdf

² www.taxaid.org.uk

³ www.taxvol.org.uk

Question 2 – Do you think there should be a formal mechanism to allow creditors to object to a debtor’s entry into a breathing space, given the protections already outlined above? How could any such mechanism be best designed to minimise administrative burden?

- 3.1.6 We do not think that creditors should be allowed to object to a debtor’s inclusion in a breathing space scheme. A period of 60 days’ suspension of action by a creditor following a debtor’s inclusion in a breathing space scheme is not unreasonable, particularly if it increases the likelihood of a managed and organised debt repayment plan being put in place which should be advantageous to creditors too.

Question 3 – Do you agree with the outline of the alternative access mechanism for individuals in mental health crisis care?

- 3.1.7 It is not clear whether those who may be suffering mental health issues such as depression and are under the care of their GP would be regarded as receiving NHS treatment in the community and so qualify for this alternative route to accessing a breathing space scheme. If they are not currently intended to be included, we believe further consideration should be given to extending the alternative access route to this group.

Question 4 – Although it will be important for a professional assessment to be made of an individual’s condition, do you agree that other third parties (e.g. carers) be permitted to use that professional assessment to make a referral to a debt advice agency on an individual’s behalf?

- 3.1.8 Yes, we think it is important for third parties to be able to engage on an individual’s behalf. In the context of dealing with HMRC, it would be helpful if a carer could use such an assessment to engage with a debt advice agency and, in turn, for HMRC to be notified of the individual’s condition so that tax debts can be dealt with accordingly.

3.2 **Administering breathing space (Questions 5-7)**

Question 5 – Do you agree with the proposed method of administering entrance into breathing space? Do you agree with the proposed role for the Insolvency Service? What kind of functionality should the Insolvency Service’s notification mechanism include?

- 3.2.1 It is important that the breathing space scheme does not become too administratively burdensome. If the Insolvency Service adopt the administrative role proposed in the consultation document then there should be a firm commitment to make maximum use of technology to manage the administration and to design a process that operates smoothly and speedily.

Question 6 – Do you think there should be an oversight role to ensure creditor compliance with breathing space? If so, how should this oversight role operate?

- 3.2.2 Yes. It would seem sensible for the Insolvency Service to have an oversight role, so that any concerns or complaints regarding creditor or debt adviser compliance with the scheme can be looked into by an independent body.

Question 7 – Do you think the register holding details of debtors in a breathing space should be fully public, accessible to relevant debt advice agencies and creditors or just accessible to the Insolvency Service?

- 3.2.3 We do not think that the register held by the Insolvency Service should be fully publicly available, as this might deter people from entering into breathing space (for example, if they were concerned that public knowledge of their debt problems could affect them in future, even when resolved).
- 3.2.4 Having said that, given that only **known** creditors are to be notified that the debtor has entered breathing space (per section 3.8 of the consultation document), it may be helpful for an online enquiry process to be set up so that a creditor could use it to check whether a debtor is currently within a breathing space scheme. This would have to be on the basis of having a good reason to carry out the check (such as evidence of the debt) so as to distinguish them from spurious or potentially malicious enquiries.
- 3.2.5 In the context of debts owed to HMRC (our area of particular interest), it could then be written into HMRC's processes (for example, the guidance for their officers contained in the Debt Management and Banking Manual¹) to carry out a breathing space check before taking enforcement action.

3.3 ***Protections of breathing space (Questions 8-9)***

Question 8 – Do you agree with the proposed approach for excluding certain debts from the protections of breathing space?

- 3.3.1 We understand that policymakers would not wish for the scheme to be exploited, and the reasons for therefore excluding certain debts from breathing space protections.
- 3.3.2 However, we do have some concerns in the context of 'debts incurred as a result of fraudulent behaviour'. In this regard, we would question who decides whether the debt has been incurred as a result of fraudulent behaviour? For example, in tax credits terms, we have often commented about how HMRC tend to conflate the terms 'error' and 'fraud' and treat the two things almost as one.² In the last few years the number of 'deliberate error' (now called fraud) tax credit compliance cases increased significantly because HMRC's approach to classification changed. Although they have now reversed this, it highlights how easy it is for people to be given a particular label without any real ability to challenge. Also, what HMRC designate as 'fraudulent behaviour' may not align with other Government departments or private companies.

¹ See <https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking>

² See for example: <https://www.litrg.org.uk/latest-news/news/170614-press-release-big-increase-tax-credit-errors---how-reliable-hmrc's>

- 3.3.3 Also in the wider business sense, does this exclusion only cover things which a court has determined are due to fraudulent behaviour or can the creditor just accuse the debtor of fraudulent behaviour?
- 3.3.4 Secondly, we note that student loans are excluded. We can see how it would be difficult to include student loans in the breathing space scheme, given that for employees repayments are generally¹ made via the Pay As You Earn (PAYE) system, by deduction from payrolled wages. In that case, however, the individual's ability to repay their debts and hence determine eligibility for the breathing space scheme must be based upon their income net of student loan deductions. Similarly, for those repaying student loans via Self Assessment, it is income net of the student loan repayment that must be taken into account.
- 3.3.5 However, for those in Self Assessment, it will also be necessary for debt advisers to understand the breakdown of any accrued 'tax' debts, as these could include student loan repayments (calculated alongside the individual's income tax, Class 2 and Class 4 National Insurance liabilities). It is not clear from the consultation how the debt adviser will be able to determine this breakdown, so that the student loan repayment element is excluded from breathing space.

Question 9 – Do you think there are other debts, such as those in regulated credit agreements, or certain types of benefits, that should be excluded?

- 3.3.6 No, and we would particularly stress that tax and tax credits (the latter being a form of welfare benefit) debts should be included in breathing space.

3.4 **Business debts in breathing space (Question 10)**

Question 10 – Do you agree with the treatment of sole traders in breathing space? In particular:

- *Do you agree with the proposed eligibility criteria and protections for sole traders in breathing space?*

- 3.4.1 We are pleased to see that individuals running their own business would be eligible for the scheme. However as the consultation clearly states that an individual will not be excluded from breathing space merely because they have income of a certain level (see section 3.4 of

¹ Except for mortgage-style loans (see http://www.studentloanrepayment.co.uk/portal/page?_pageid=93,3867002&_dad=portal&_schema=PORTAL); or sometimes in cases where the person is within two years of full repayment, in which case they can switch to paying by monthly direct debit (see <https://www.taxguideforstudents.org.uk/student-loans/i-have-a-plan-1-and-plan-2-loan-how-do-my-repayments-work>).

the consultation document, second paragraph¹), we do not see why a self-employed individual should be excluded from the scheme due to the level of their gross turnover, which would clearly be the case if they are ineligible purely because their turnover is above the VAT threshold. There are lots of small business people making very modest profits who have to be VAT registered (for example, seasonal businesses like cafés, tea rooms, restaurants) but who can encounter debt difficulties due to unforeseen circumstances, and it seems inequitable that they should be excluded purely on the grounds of turnover.

- 3.4.2 Also, if there were to be an exclusion based around the VAT threshold, this comes with its own problems. For example, what period would be used to assess whether the threshold is exceeded? Or would it simply be that anyone who is VAT registered at the time of applying for breathing space would be excluded from the scheme? The latter would also ‘catch’ certain traders whose turnover is beneath the threshold but who are voluntarily VAT-registered, such as those that make zero-rated supplies.
- 3.4.3 It is also possible that someone has VAT liabilities having registered in a period of much higher turnover, and their business has later suffered a downturn which has resulted in problem debt. We cannot see that it would be right to exclude them from the breathing space proposals, or indeed that VAT should not be included in the list at section 4.3 of the consultation document (which does not expressly appear to include VAT²).
- 3.4.4 We also wish to point out in response to this question that it is not only businesses that might accrue PAYE debts. Individuals can become employers in a private capacity – for example, someone employing a personal assistant to help them with domestic or personal care needs.³ It is possible for such individuals to encounter difficulties with operating their payroll and to fall behind in payments of PAYE to HMRC. We must stress that these arrears also need to be within scope of these proposals, not just PAYE debts of businesses.
- 3.4.5 Finally on this question, other payroll deductions appear to be missing from the list at section 4.3 of the consultation document. Employers are now required to automatically enrol qualifying workers into a workplace pension and make contributions on their behalf, as well as deduct workers’ contributions from the payroll. They are then required to pay these into the employees’ pensions. It is possible that an employer who has fallen behind in PAYE payments might also have failed to pay such contributions to the pension provider. Clarity is needed on whether such amounts are within the scope of these proposals or not.

- *What would be the most appropriate way of distinguishing between business and personal debts for these purposes?*

¹ Which says: “The government does not believe that specific rules, such as basing eligibility for breathing space on debt or income levels, would be appropriate...”

² List at 4.3 of the consultation document, second bullet.

³ See for example our Disability Tax Guide website: <https://disabilitytaxguide.org.uk/Setting-things-up>

3.4.6 We do not see the need to distinguish between business and personal debts: all debts of a sole trader should be covered by the breathing space.

3.5 ***Treatment of ongoing liabilities (no specific question asked)***

3.5.1 We offer here some observations in relation to section 4.4 of the consultation document, although no specific questions are asked in relation to the treatment of ongoing liabilities.

3.5.2 First, while we can understand the requirement for an individual to service their ongoing liabilities during the breathing space period, for some individuals this will be impossible – perhaps because they have lost their job or a household member has moved, become ill or died. Excluding such individuals might mean some very vulnerable people could lose the benefit of this vital protection.

3.5.3 Second, the list of ongoing liabilities includes the very broad bullet point ‘taxes’, but it is not clear whether this means just council tax (as referred to in the first paragraph of section 4.4) or all taxes. We assume the latter, but this requires clarification.

3.5.4 In any case, we cannot understand how this would work if it includes income tax, for example, if historical tax liabilities are subject to breathing space rules. This is because it is understood that HMRC generally apply any payments to oldest tax liabilities first¹ (to prevent penalties and/or interest accruing on the oldest sums outstanding). Therefore, HMRC’s systems would need to be geared up to apply any payments made during a breathing space period to current liabilities, instead of the older ones.

3.5.5 However, this could prove to be ultimately unhelpful if the older liabilities once again become ‘live’ at the end of a breathing space period, with consequent penalties being charged. For example, HMRC guidance states that individuals may request payments to be offset in a different way to the ‘oldest first’ rule, but goes on to say that because there is no right of appeal against payment allocation, the only option on HMRC refusal is to seek Judicial Review.² Clearly, it would not be acceptable for the individual to be left in the position that they were in fact worse off as a result of entering into breathing space, and for their only remedy to be Judicial Review (which is unlikely to be an accessible course of action for low-income taxpayers).

3.5.6 Far more explanation is therefore required as to how the breathing space would apply in relation to tax liabilities. We recommend that HMRC:

- explore these issues in full;

¹ See Debt Management and Banking Manual, DMBM210110: <https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking/dmbm210110>

² See Debt Management and Banking Manual, DMBM210110: <https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking/dmbm210120>

- address any pitfalls for taxpayers in terms of gaps between the breathing space rules and tax/tax credits recovery legislation; and
- publish clear guidance.

3.5.7 In carrying out such a review, we assume that HMRC will be able to use and build on their existing Scottish Debt Arrangement Scheme (DAS) guidance.¹

3.6 ***Treatment of interest, fees and charges (Question 11)***

Question 11 – Do you agree with the proposed treatment of interest, fees and charges in breathing space?

3.6.1 We agree with the proposed treatment of interest, fees and charges and note it is in line with our recommendation in our response to the call for evidence.

3.6.2 The protection should also be extended to cover penalties incurred in relation to the individual's tax and tax credit affairs. Indeed, it is essential that HMRC are notified of the individual having entered breathing space and for the breathing space provisions to be joined up with tax law (as discussed at 3.5.6 above).

3.6.3 It must be absolutely clear that entering into a breathing space is to be treated in the same way as a person having entered into a formal agreement with HMRC as regards their tax debts. For example, the current penalty regime for late payment under Self Assessment (Finance Act 2009, Schedule 56, paragraph 10²) says that HMRC can agree to deferred

¹ See HMRC's Debt Management and Banking Manual, DMBM900400 et seq:

<https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking/dmbm900400>

² ***Suspension of penalty during currency of agreement for deferred payment***

10(1) This paragraph applies if—

- P fails to pay an amount of tax when it becomes due and payable,
- P makes a request to HMRC that payment of the amount of tax be deferred, and
- HMRC agrees that payment of that amount may be deferred for a period ("the deferral period").

(2) If P would (apart from this sub-paragraph) become liable, between the date on which P makes the request and the end of the deferral period, to a penalty under any paragraph of this Schedule for failing to pay that amount, P is not liable to that penalty.

(3) But if—

- P breaks the agreement (see sub-paragraph (4)), and
- HMRC serves on P a notice specifying any penalty to which P would become liable apart from sub-paragraph (2),

P becomes liable, at the date of the notice, to that penalty.

(4) P breaks an agreement if—

- P fails to pay the amount of tax in question when the deferral period ends, or
- the deferral is subject to P complying with a condition (including a condition that part of the amount be paid during the deferral period) and P fails to comply with it.

(5) If the agreement mentioned in sub-paragraph (1)(c) is varied at any time by a further agreement between P and HMRC, this paragraph applies from that time to the agreement as varied.

payment of a liability and then, provided the taxpayer sticks to the agreement, no penalties will be charged during the deferral period.

- 3.6.4 The legislation makes it clear that the taxpayer has to make a request to HMRC for the deferral and that HMRC have to agree. Unless there is some overriding provision in the breathing space rules (or an amendment made to FA 2009, Sch 56), it therefore appears that late payment tax penalties would continue to arise.

3.7 ***Collections and recovery action during breathing space (Questions 12-13)***

Question 12 – Do you agree with the treatment of collections recovery action during breathing space? Should any other forms of collections and recovery action be explicitly included in the protections? How can any practical issues arising from preventing these collections and recovery actions be best mitigated?

- 3.7.1 We broadly agree with the proposals within section 4.9 of the consultation document, subject to two comments.
- 3.7.2 The first of the protections in the bullets at 4.9 says: ‘stopping... **certain types of** new and existing benefit reduction (where benefits are reduced in order to pay a debt).’ Why only ‘certain types’, rather than stopping any new reductions of benefit being put in place during the breathing space period? This statement seems too broad – further clarification is essential.
- 3.7.3 The second of the bullets in section 4.9 of the consultation document refers to pausing enforcement agent action. We assume that this includes all types of enforcement action that HMRC are permitted to undertake,¹ such as distraint action in the form of bailiff visits, but would welcome clarification of this.

Question 13 – How should creditor compliance with the scheme be monitored?

- 3.7.4 As a first step, creditors should be required to acknowledge receipt of the notice of a debtor joining the scheme and to confirm in their response that they will remain compliant with the scheme rules during the period. If there is a need to monitor creditors further, this should be considered by the Insolvency Service in due course.

3.8 ***Operation of 60 day breathing space (Question 14)***

Question 14 – Do you agree with the proposed length of breathing space? Do you have any other comments on the operation of the check?

- 3.8.1 We are pleased to see that the breathing space period is now 60 days and not six weeks, as we noted in our earlier submission that in our view a six-week period was too short. We understand that this 60-day period would run from the time when the individual has seen a

¹ See <https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking/dmbm650000>

debt adviser, who has then activated the breathing space period in order to then put in place longer term solutions.

- 3.8.2 That said, we still believe that 60 days will be insufficient in many cases involving tax or tax credits debt, in terms of both establishing whether the debt is correct (or is in fact due at all) and then agreeing repayment. We are still not clear from the consultation document what will happen at the end of the 60-day breathing space period if these issues have not been resolved. We suggest there needs to be some flexibility as to the breathing space period in such cases (at least in terms of the tax/tax credits aspects of the case).
- 3.8.3 The proposal for the debt adviser to carry out a formal check on the individual's financial status after 30 days is adding another layer of administration to the system. We recommend that further consideration be given to the perceived benefits of carrying out such a review to make sure they outweigh the additional administrative burden that will be imposed on debt advisers by this measure.

4 Response to consultation questions on statutory debt repayment plan (SDRP)

4.1 Eligibility for a statutory debt repayment plan (Questions 16-18)

Question 16 – Do you agree with the eligibility criteria for entering a plan? In particular, do you agree that plans lasting for a maximum of ten years is an appropriate timeframe for debt repayment?

Question 17 – Do you agree with the proposed criteria for creditors to object to the plan? Are there any other criteria you feel would be appropriate?

Question 18 – Do you agree with the design of the proposed fair and reasonable test? In particular:

- *Do you agree that 14 days is an appropriate timeframe for creditors to object to a proposed plan?*
- *Following an Insolvency Service decision that a plan is fair and reasonable, do you think that creditors and debtors should be able to make any further objection if they feel the Insolvency Service's decision is incorrect? If so, how should an objection mechanism work to minimise disruption and administrative burden for parties involved in the plan?*

- 4.1.1 We take all of the above questions together.
- 4.1.2 The eligibility criteria for this plan seem reasonable, as do the terms on which creditors can object.
- 4.1.3 We strongly support the introduction of a 'fair and reasonable assessment' in the event of objections from more than 25% (by debt value) of creditors. We understand that IVAs can

fail if even one large creditor (who is owed more than 25% of the debt) objects¹ and so this assessment would effectively provide an independent review route for creditors. It is important that such a review is carried out quickly and the result communicated quickly to all parties by the Insolvency Service.

Question 19 – Do you agree with the debts included within a plan? Should any other debts be excluded, or excludable on request?

- 4.1.4 As taxes are not on the list of excluded debts in section 7.1 of the consultation document, we assume they are in scope. As referred to in our comments above relating to breathing space, we recommend that HMRC review the interaction of statutory debt repayment plans with tax law and that they set out whether any issues arise in terms of gaps between the new rules and existing tax law.

4.2 ***Treatment of interest, fees and charges (Question 20)***

Question 20 – Do you agree with the proposed treatment of interest, fees and charges within the plan?

- 4.2.1 We support the proposed treatment of interest, fees and charges in an SDRP and note it is consistent with the proposed treatment in the breathing space schemes. Again, we recommend that penalties raised by HMRC are included.

4.3 ***Treatment of collections and recovery action during the plan (Questions 21-22)***

Question 21 – Do you agree with the proposed protections within a plan? Are there any unintended consequences that could arise from providing these protections to debtors?

- 4.3.1 Broadly speaking, yes, though we have the same queries as to the relationship with tax and tax credits debts as raised in our various answers to the breathing space questions above.

Question 22 – How do you think creditor compliance with the scheme’s protections can be best monitored? Should creditors who fail to comply face any additional sanction?

- 4.3.2 In our response to the call for evidence,² we suggested that government debt collection practices could best be explained by publication of a formal ‘Code of Practice’. Compliance with that code could then be monitored independently – for example, by the National Audit Office which has previously reviewed HMRC’s management of tax debt.³

¹ See <https://www.stepchange.org/debt-info/getting-an-iva.aspx>

² See <https://www.litrg.org.uk/sites/default/files/180116-LITRG-response-HMT-breathing-space-FINAL.pdf>

³ See: <https://www.nao.org.uk/press-release/hm-revenue-customs-management-of-tax-debt-2/>

4.4 **Model for prioritisation (Question 23)**

Question 23 – Do you agree that some debts should be prioritised for repayments within the plan? If so, do you agree with the debts that the government proposes to prioritise, and the method of prioritisation?

- 4.4.1 We note that at section 7.4 of the consultation document that ‘certain tax and benefit debts (owed to both central and local government)’ are amongst those listed as priority debts. This prioritisation is ‘based upon existing debt advice best practice’.
- 4.4.2 We understand, however, that existing best practice allocates a priority to tax and other debts based upon the urgency of repayment – for example, if the individual is likely to lose their home because of non-payment, or have their electricity supply cut off. In the case of non-payment of Self Assessment tax, for example, the consequence of non-payment would be that the taxpayer might incur additional penalties.
- 4.4.3 However, the idea of a SDRP is to suspend enforcement action such as distraint and to prevent any further penalties accruing (and, as we have commented elsewhere, breathing space and SDRP schemes **should** be implemented such that tax enforcement and penalties are included in such suspension). Viewed in that light, would tax debts still be a priority? We can see no reason in that case why they should rank higher than any other debt.
- 4.4.4 We can, however, potentially see a clear case for National Insurance contributions debts to be repaid in priority – for example, where non-payment of Class 2 National Insurance means that the individual has not made sufficient contributions to make up a qualifying year for welfare benefits purposes. In particular, this might be detrimental to the accrual of their state pension entitlement (leading to further poverty later in life).
- 4.4.5 **Flexibilities included within a plan (Question 24)**

Question 24 – Do you agree with the two key plan flexibilities outlined above? Should the plan offer any other flexibility that would help to make it sustainable over time?

- 4.4.6 We support the proposals to have annual reviews of the plans, and for individuals to be able to request a payment break of up to six months in the event of a severe, but temporary financial shock.
- 4.4.7 In addition, it is welcome that an individual would be able to contact their debt adviser at any point to review their payments, should their surplus income change (as outlined in the first paragraph of section 7.7 of the consultation document).

Question 25 – Do you have any specific comments about how these flexibilities should work? In particular, how do you think a severe, temporary, financial shock should be defined?

- 4.4.8 Clearly, there would be a concern that a six-month suspension period could be exploited if drawn too wide, however we think it is important not to have a defined list of circumstances in which it will apply. For someone in a debt repayment plan, money is likely to be tight, so

that any financial shock – which might just be the oven breaking down and having to buy a new one – means that they will temporarily struggle to pay.

- 4.4.9 We would point out that in case law on what is a reasonable excuse for tax purposes, HMRC's reference to events having to be 'unexpected, unusual, unforeseen or beyond [the individual's] control' has been overturned by the tax tribunals in many cases. We would strongly recommend that similar terminology is therefore **not** used in this definition. The definition should instead be couched in terms of what may reasonably be considered to be a severe shock in the individual's circumstances and not by reference to an arbitrary scale or limited to exceptional events.

4.4.10 ***Ongoing eligibility for the plan (Question 26)***

Question 26 – Do you agree with the requirements for continued eligibility for the plan?

- 4.4.11 Again, the requirements for ongoing eligibility seem reasonable and should not be too onerous for the debtor who genuinely wishes to deal with their problem debt.
- 4.4.12 However, there needs to be further clarity surrounding failure to comply and the notice of non-compliance/failure to respond/final notice to comply described at section 7.9 of the consultation document. There are many reasons why individuals might fail to respond to an interim notice, or even a final notice – for example, they have fallen seriously ill, suffered a bereavement or other similar difficult circumstances. The short period to comply suggested in the consultation might therefore helpfully include some form of 'reasonable excuse' provision as there is in tax law; and for the SDRP to be reinstated if the individual can prove that there was a good reason for not complying and for failing to respond to communications.

4.4.13 ***Payment distribution (Questions 27-28)***

Question 27 – Should the plan's funding mechanism system be based on taking a share of creditors' monthly repayments?

- 4.4.14 No comment.

Question 28 – How should payment distribution in the plan be done? Should it be offered by an individual's debt advice agency, if they have appropriate handling client money permissions, or by the Insolvency Service, or is there any other model that the government should consider?

- 4.4.15 We have no detailed comment to make here, except that if an intermediary is making payments to HMRC on behalf of a taxpayer in a SDRP, they will need to make sure that appropriate references are given when making the payments. Otherwise, HMRC will be unable to allocate the payments to the taxpayer's account correctly. This position will be complicated where more than one type of tax is owed (for example, a Self Assessment liability and PAYE arrears owed by a sole trader) as different references for payment of each will be required.

4.4.16 Credit referencing (Question 29)

Question 29 – Do you have views on how a breathing space and plan should be reflected on a debtor’s credit file?

4.4.17 As noted in our response to the call for evidence,¹ if entering into a breathing space or plan were 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.

4.4.18 Territorial scope of the scheme (Question 30)

Question 30 – Do you agree with the proposed territorial scope of the scheme?

4.4.19 We have no comments, except to say that guidance for individuals should be clear as to which scheme they can use if there are different rules in Scotland, Northern Ireland, and England and Wales.

4.4.20 Particular confusion might arise if, for example, the individual lives in England at the time they need to seek help for problem debt, but has a tax liability arising from a time in which they were resident in Scotland and as a result have a tax debt which includes Scottish income tax. Would they be eligible in that respect for the scheme as it applies to England and Wales, or would they fall under the Scottish DAS rules? We can see this causing a great deal of confusion for debtors, creditors and advisers alike.

LITRG

29 January 2019

¹ <https://www.litrg.org.uk/sites/default/files/180116-LITRG-response-HMT-breathing-space-FINAL.pdf>, para 10.1