Low Incomes Tax Reform Group.
A voice for the unrepresented.

Requiring payment of VAT and PAYE return liabilities by Direct Debit
Response from the Low Incomes Tax Reform Group (LITRG)

1. Executive Summary

1.1 We are responding to this consultation on behalf of small and micro businesses and employers who fall within the VAT and PAYE for employers regimes.

1.2 We are concerned that, given the significance of the proposals, the document lacks detail and the consultation period is short over a holiday period. This does not provide adequate time to prepare thorough responses, especially when it sits alongside several other important consultations with similarly short timescales.

1.3 The consultation assumes that direct debit is inherently preferable, but the consultation does not reference any evidence or research that has been done to understand why the majority of businesses and employers have not already adopted it. If taxpayers are not actively choosing direct debit at the moment, HMRC should first identify and consider the reasons why this is the case.

1.4 Mandatory direct debits also mean HMRC controls the collection date once the relevant return has been submitted. This represents a significant shift in control from the taxpayer to HMRC and therefore should require compelling evidence that the benefits outweigh the potential costs for those affected – this analysis is missing in the consultation.

1.5 While direct debit may be more convenient for some, convenience is not the same as flexibility, and it is flexibility that many small and micro businesses and employers need, as they have potentially the least administrative capacity and the greatest cash flow pressures. Mandating direct debit risks reducing that flexibility and could result in failed payments despite taxpayers having every intention of meeting their obligations.

1.6 Mandating payment by direct debit may also create new compliance risks for taxpayers who currently pay accurately and on time using other methods.

1.7 There are two groups that we have particular concerns about: voluntary VAT registrants and individual employers (such as care and support employers). For these groups, mandatory direct debit raises particular issues, including around the scope of any mandatory collections (for example, whether VAT assessments, as well as self-assessed liabilities, would be included) and how HMRC would deal with incorrect or duplicate collections.

1.8 Under any mandatory model, there would need to be a straightforward and responsive process for resolving overpayments, reclaiming funds, amending liabilities and correcting errors. Delays could create significant financial difficulties for businesses and employers with little financial resilience.

1.9 We welcome HMRC's acknowledgment that some taxpayers who do not file online could face real challenges with mandatory direct debit, such that they might need an exemption. If HMRC decide to proceed, small and micro businesses, voluntary VAT registrants and individual employers should also be considered for exemption, alongside those that are digitally excluded, do not use internet banking, or face similar barriers (while direct debit is generally accessible, the surrounding administration is not always).

1.10 A voluntary payment method that taxpayers actively choose is likely to command greater trust, achieve better compliance and require fewer safeguards than one that is imposed, and so we do not support mandatory payment by direct debit for PAYE and VAT.

1.11 Any expansion will need to be supported by improvements to HMRC's systems and processes and should not be enforced through penalties.

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 who are least able to pay for professional advice. We also produce free information, primarily via our website www.litrg.org.uk, to help make a difference to people's understanding of the tax system.

2.2. LITRG works extensively with key stakeholders such as HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the tax system. LITRG also considers the welfare benefits system, and other related systems, to the extent that they interact with tax.

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. HMRC is consulting on proposals that would require most VAT and PAYE payments to be made by direct debit, replacing the wide range of payment methods currently used, including bank transfers, debit cards, standing orders and, in some cases, cheques.

3.2. On the face of it, this may seem like a small tweak, and the short consultation window may reinforce that impression. However, this change would require businesses and employers to ensure that funds for tax bills are in the right account, on the right day, every single time. For some, it would be one of the biggest administrative changes in recent years, and it warrants more scrutiny than the consultation timetable currently allows.

3.3. The consultation states that the changes would affect around 2.4 million businesses and employers (87% of the 2.73 million businesses registered for VAT and PAYE) who are not currently paying by direct debit, despite HMRC encouraging it as its preferred payment option. It would therefore be helpful to understand why businesses and employers have not already adopted direct debit, and whether HMRC has explored these barriers. For employers, some reluctance may stem from the problems in 2022/23, when HMRC issued late payment notices because payments were collected after the statutory due date[1]. There is no reference to this in the consultation nor any explanation as to what has changed since then that might help deal with any reluctance.

3.4. Overall, the proposal may be more understandable for medium and large businesses and employers that are well organised, have developed administrative systems, receive accountancy or payroll support, and have predictable cash flow. In these circumstances, automation could have advantages. It could help ensure VAT and/or PAYE liabilities are paid accurately and on time, reduce the risk of missed payments, late payment penalties and interest charges, and provide greater assurance that businesses and employers are meeting their HMRC obligations.

Impact on particular groups

3.5. However, not all businesses or employers are like this. Small and micro businesses and employers in particular may not have accountants, dedicated business bank accounts or robust administrative processes. They may also face significant cash flow issues, which we discuss below.

3.6. Furthermore, the small and micro group is far from homogenous. It includes low-paid people who are voluntarily VAT registered (for example because they have been told by engagers that it can help subsidise their earnings) and individual employers such as disabled people who employ their own carers. These groups may face unique challenges under a mandatory direct debit model, which we explain below.

Errors and disputed collections

3.7. Unrepresented low-income business and employers may be less likely to be able to deal with errors if and when they arise. We appreciate that direct debit has protections: if the amount, date or frequency changes, the organisation should normally notify the payer in advance, and if an error is made, the payer is entitled to a full and immediate refund from their bank or building society. But it is not clear what happens where the error is more complex or there is a dispute.

3.8. If HMRC has already collected the money, it becomes even more important that there is a straightforward and responsive process for correcting errors, amending liabilities, overpayment disputes and reclaiming funds. Delays in resolving these issues could create financial difficulties for businesses or employers, particularly where they are low-paid and operate on limited budgets with little financial resilience. Will there be an HMRC process rapid enough to prevent serious hardship where an employer or business suddenly faces an unexpected and/or unjustified cash flow shortfall of hundreds or thousands of pounds?

[1] As reported here: https://www.att.org.uk/employers/welcome-employer-focus/paye-direct-debits-watch-your-timing

Penalties

3.9. More significantly, HMRC is also considering penalties for those who fail to pay by the required method, even where the correct amount of tax has been paid on time. We do not support HMRC penalising those who pay in full and on time simply for using the 'wrong' channel. Punishing taxpayers not for failing to pay, but for failing to use HMRC's preferred payment method, undermines the principle that penalties should primarily address failures to meet tax obligations.

3.10. Instead of considering penalties, HMRC should use some resource to educate taxpayers as to what they consider to be the benefits of paying by direct debit, so more people want to use this payment method. If HMRC decides to proceed, we recommend that the penalty aspect is dropped, as it could damage trust in the system.

4. **Cashflow concerns**

4.1. Small and micro businesses and employers may have tight margins, seasonal income or fluctuating VAT and PAYE bills. Sometimes, dealing with tax is secondary to keeping a business afloat or finding enough work to keep employees on. The discretion to pay early or pay at the last sensible moment so that cash can be held for longer, has real value. Taxpayers need freedom to pay from whichever bank account is healthiest, which occasionally may even be the account of a friend or family member. For them, it may be vital to initiate each VAT or PAYE payment manually.

4.2. It is not unusual for small and micro businesses to sometimes have to set up short term time to pay agreements with HMRC to pay their VAT or PAYE. HMRC currently makes this quite straightforward to do with an online facility available to set up such an arrangement in certain circumstances. Mandating direct debit removes this flexibility – flexibility that is not about avoiding tax but about managing funds while remaining compliant. It does not sit comfortably with HMRC's debt management approach and raises questions such as:

- What happens if someone knows they cannot afford the direct debit? Should they attempt to stop it?
- Will taxpayers understand that they cannot simply cancel direct debits or unilaterally move the collection date?
- Does entering time to pay automatically suspend collection?
- Does a failed collection prejudice later time to pay discussions?

4.3. The main risk of mandating direct debit without fully considering all these issues is that there may not be sufficient funds available when HMRC tries to collect the payment. This already carries the risk of penalties and late payment interest. There are also likely to be bank charges incurred when a direct debit payment cannot be paid.

4.4. Further practical consequences of a failed direct debit are illustrated by the following experience shared with us by one small business owner:

> *'Paying by DD may seem easy, and all is great until it goes wrong. I was paying by DD, but one time got my cash flow wrong and there were insufficient funds in the account to pay the VAT. I got the notification and transferred the required funds to the account and reset the DD, but missed the point that when a DD fails, they do not resubmit it and the payment needs to be*

made manually. The next I heard about it was that it had been sent to collections with additional fees and fines. So sometimes the ease of DD can lead you to forget to check things, as you believe it is all done automatically.'

4.5. There are also wider questions about the implications of HMRC, in effect, becoming a preferred automated creditor by removing the taxpayer's ability to decide the order in which payments are made. Many small businesses and employers manage very tight cash flow and may sometimes have to choose whether to pay suppliers, employees' wages, rent or their next HMRC bill, for example because a large client has paid late. Although this is not ideal, the long-term consequences of missing business-critical payments are likely to be greater than the consequences of paying HMRC late, and accepting that interest and penalties arise.

4.6. Mandating direct debit could introduce a further risk in that businesses may avoid filing returns at all because they fear triggering automatic collection when they can't afford to pay the amount due immediately, rather than filing and paying later as they may do currently. This could cause businesses to become inadvertently non-compliant and in the worst cases, this could contribute to business failure. Before moving ahead with the proposals, HMRC should undertake a rigorous assessment of potential behavioural changes across the whole population.

4.7. These general cash flow and administrative concerns may be particularly acute for certain groups – alongside some other issues - which we discuss below.

5. **Voluntary VAT registrants**

5.1. The labour market is such that low-paid workers are sometimes persuaded by their engagers — or sometimes even placed without their full authorisation — into the VAT regime due to perceptions that the flat rate VAT scheme can top up their earnings.

5.2. These VAT accounts are sometimes managed almost entirely by certain agents connected with the engager, with the worker understanding little or nothing about what is happening behind the scenes. If the agent-taxpayer relationship breaks down, nothing further may happen on the VAT account. Alternatively, the worker may receive an unexpected payment request because these agents have submitted a VAT return on their behalf that they did not see beforehand. In either case, the worker can quickly fall behind on returns and/or payments and into non-compliance. We have previously raised concerns over these practices with HMRC.

5.3. The proposal to mandate direct debit seems particularly dangerous in this context, especially if these particular agents will be allowed to set up mandates and if it extends to VAT assessments rather than only self-assessed liabilities. We would welcome clarification from HMRC on these points.

5.4. Further to our comments in section 3, there are also questions about how quickly and easily VAT collected in error by direct debit could be recovered, for example where an agent submits an incorrect VAT return that is later amended, or where HMRC agrees to unwind the registration from the start because it is clear that the worker did not intend to register voluntarily for VAT.

6. Individual employers

6.1. Unlike commercial employers, many employers who are private individuals are not running a business. These include disabled people who receive Direct Payments to employ their own care and support workers. Their administrative capacity and understanding of payroll obligations may therefore be more limited.

6.2. Some may have payroll support in place, and signing up to direct debit could simplify their experience. However, others manage payroll without formal support. Direct Payments must be paid into a specific bank account, often tightly managed and ring-fenced for care and support costs. In many cases, funds are received every four weeks — which aligns with neither monthly nor quarterly tax payment cycles — and are usually spent on care within relatively short periods. Attaching mandatory direct debits to such accounts could increase the likelihood of failed collections, despite employers intending to meet their responsibilities one way or another. Payroll errors (see section 3) can also frequently occur for this cohort, and unrepresented employers may worry about PAYE liabilities being collected before errors are resolved.

6.3. Another practical consideration relates to changes in Direct Payment bank accounts. Within Adult Social Care, it is not uncommon for account details to change due to changes in banking arrangements and/or transitions between services. For example, when a young person transfers from Children's Services to Adult Services, a new Direct Payment account is often established and the previous account closed. It would therefore be important to understand how accessible and straightforward it would be for employers, payroll providers or support services to amend direct debit details, and how quickly such changes could be processed by HMRC. Any delays could increase the risk of failed collections, payment issues and unnecessary administrative burden.

7. Conclusion

7.1. While direct debit may be a convenient payment option for many businesses and employers, the proposal risks reducing flexibility for those with potentially the least administrative capacity and the greatest cash flow pressures, while creating new compliance risks for taxpayers who currently pay accurately and on time using other methods.

7.2. We recommend that HMRC does not mandate direct debit at this time. Instead, it should undertake and publish further research into why the overwhelming majority of people are not currently using direct debit. Understanding those reasons should be a prerequisite to considering a mandatory approach.

7.3. If HMRC does decide to mandate direct debit anyway, the scope of exceptions to mandating should be widened so that it remains a voluntary option for some groups, particularly small and micro businesses, voluntary VAT registrants and individual employers. However we reiterate that a voluntary payment method that taxpayers actively choose is likely to command greater trust, achieve better compliance and require fewer safeguards than one that is imposed.

LITRG
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