

LOW INCOMES TAX REFORM GROUP

HM Revenue and Customs and the Taxpayer Modernising Powers, Deterrents and Safeguards Payments, Repayments and Debt

RESPONSE TO CONSULTATIVE DOCUMENT OF 10 JANUARY 2008 AND DRAFT LEGISLATION

1. Executive summary

- 1.1. The Low Incomes Tax Reform Group (LITRG) was set up by the Chartered Institute of Taxation to be a voice for the unrepresented in the tax system.
- 1.2. We welcome this opportunity to respond to the further consultation document on *Payments, Repayments and Debt*, issued on 10 January 2008. We have previously submitted responses¹ to the other consultations in this series and attended workshops to discuss the proposals in more detail.
- 1.3. We are disappointed that the current consultation only fulfils part of the promise of the original. Whilst it is suggested the other options from the 25 June 2007 document are still under consideration, most of the current proposals serve to strengthen HMRC's powers on debt enforcement. Whilst appreciating that other proposals need careful consideration, we would have preferred to see a more balanced initial package of measures; including for instance the possibility of flexible payment arrangements such as those outlined in para 4.6ff of the original consultation and that we supported in our response (with the caveat that they should be available to everyone, not only businesses). These should not be jettisoned in favour of a series of 'quick wins' for HMRC.
- 1.4. As part of this consultation, there needs to be an acknowledgement from HMRC that its deficient service delivery can in itself lead to taxpayers getting into debt; for example as a result of insufficient guidance. This problem has been exacerbated over recent years with the trend to withdraw leaflets and move to web-based guidance which is inaccessible to many. Customers also struggle to obtain clear explanations of how a debt has arisen; again, a problem which has been compounded in recent years through HMRC's move to call-centre based helplines and the diminishing availability of face-to-face services. HMRC's poor performance

¹ See <http://www.litrg.org.uk/reports/submissions.cfm>

in these areas needs to be urgently addressed and demonstrably improved *before* introducing more stringent enforcement methods. We understand that TaxAid are making similar comments in their response to this consultation, which we fully endorse.

- 1.5. It is stated that the 25 June 2007 document 'consulted on a package of measures which, **taken together**, would:
 - make it easier for those who wish to pay on time to do so;
 - address the extra costs to taxpayers that arise from different regimes; and
 - deal firmly with those who choose to delay payment, or not to pay at all.'
- 1.6. In the current consultation, we find it difficult to identify the measures which fit into the first of these bullets. The exception might be the extension of credit card payments; but for the low-income population this measure is unlikely to be of much assistance and might only result in customers switching public debt to private. As a consequence, we very much hope that the possibility of a flexible payment scheme will resurface shortly.
- 1.7. Turning to the other measures now proposed, the general aim of removing the inconsistency in enforcement powers is sensible and the legislation seems broadly appropriate.
- 1.8. The set-off proposals in the draft legislation are one-sided, giving HMRC discretion to exercise this power. A more balanced clause should be introduced, making clear the taxpayer's right to also elect for set-off. If HMRC feels that common law principles render it unnecessary to specify the taxpayer's right in this legislation, then public guidance on this issue must be made clearer. There is also a noticeable absence of an appeal right against the set-off, which must be rectified in the final drafting.
- 1.9. We are also disappointed that the proposals on set-off still suggest that tax repayments should be offset against tax credits overpayments; something we recommended against in our response to the 25 June 2007 consultation and reiterate here.
- 1.10. As with any changes in operation of the tax system, all these provisions need to be clearly communicated to taxpayers. Guidance needs to be available in a range of formats and must cater for disabled people and those with other special needs.
- 1.11. Throughout the consultation document, a range of safeguards is promised. But it is proposed that these will be incorporated in HMRC guidance and practice rather than being enshrined in statute. We would always prefer to see safeguards incorporated in the law to give taxpayers maximum protection.

2. Removing inconsistencies in HMRC's current enforcement powers

Enforcement by taking control of goods: England and Wales

- 2.1. The operational effect of these changes will depend upon regulations supporting Schedule 12 of the Tribunals Courts and Enforcement Act which have yet to be published. For example, we would want to ensure that these regulations retain the minimum holding period for goods of 5 days under Section 61(4) of the Taxes

Management Act.

- 2.2. Under TMA Section 61 as it stood before amendment by the Tribunals Courts and Enforcement Act 2007 (and still stands in Northern Ireland), entry to premises was controlled by warrant issued by a magistrate. Similar provisions applied in Section 121A of the Social Security Administration Act 1992. We understand that under Schedule 12 of TCEA 2007, para 14, which will replace the provisions of section 61 in England and Wales, entry may only take place with the approval of the court, which is in our view a vital constitutional safeguard and we are pleased that it is to be retained.
- 2.3. We understand that HMRC has been consulting on draft regulations under TCEA 2007, Sch 12 with the Ministry of Justice and that the latter will issue a draft for public consultation in due course.

County court proceedings

- 2.4. We have no particular comments to make on the draft text of Clause 2.

3. Set-off

3.1. Comments on draft legislation

Agreed liability

- 3.1.1. We are concerned that Section 3(6) proposes set-off of amounts which are not established by including 'any purported or anticipated liability' within the definition of 'relevant sum'. Set-off should only be operated in relation to *established* debts.

Tax credits

- 3.1.2. Para 2.16 of the *Responses to Consultation and Proposals* document states that 'HMRC may use a tax repayment to reduce the amount of overpaid tax credits owed by the same taxpayer, but tax credits will not be used to reduce a tax debt.'
- 3.1.3. Firstly, we do not agree that tax credits should be brought within the set-off proposals at all. Tax credit overpayments should be treated differently due to the way in which they can arise, for example that claimants can find themselves in debt through no fault of their own, having fulfilled every obligation required by them under the law.
- 3.1.4. Secondly, Code of Practice 26 provides for recovery of overpayments as a percentage of an ongoing award, depending on the nature of the tax credits award itself. Offsetting income tax repayments against tax credit overpayments could prejudice the nature of this phased recovery and, in turn, create family hardship in cases where a direct tax repayment was anticipated.
- 3.1.5. Thirdly, anticipated repayments of tax could also be earmarked to clear other, more pressing debts (such as utilities or food bills). These should not therefore be seized by HMRC in preference to those other creditors, with the risk that non-payment of essential living expenses will cause the customer to fall deeper into poverty. Such a provision would clearly run counter to the Government's overall strategy to reduce and eliminate child poverty, a strategy which HMRC has been charged with a key role in delivering.

- 3.1.6. Fourthly, a tax credit overpayment often does not become an established debt in the sense envisaged in the condoc. People still receive consecutive award notices that conflict with each other as to the quantum of the overpayment. When claimants seek an explanation of how their overpayment arose and how it was calculated, HMRC are often unable to tell them. A high proportion of tax credit overpayments are disputed by claimants, and even those that are confirmed following a dispute are written off subsequently following an official complaint, or reference to the Adjudicator. Sometimes 'phantom' overpayments creep on to the system, especially where there has been a mixture of manual payments and system payments (eg where the system erroneously identifies a duplicate payment).
- 3.1.7. We therefore urge HMRC to exclude tax credits from offsetting altogether.
- 3.1.8. In the case of a joint tax credits claim, there are further complications: tax credit overpayment debts incurred by a couple are joint and several in nature, whereas tax repayments are owed to a single individual. Viewed equitably (and in accordance with COP26¹), the starting point is generally that overpayment recovery is sought 50:50 from each partner. Offsetting a tax repayment of one partner against the entire overpayment will disturb this practice.
- 3.1.9. The mismatch between debtor and creditor will also make the offsetting provisions all the more difficult to reconcile in practice. This is even more pertinent where there is more than one overpayment: In such cases, there will be problems in prioritising the offset, particularly where there has been a series of household changes and successive joint claims with different partners etc.
- 3.1.10. In any event, the draft Section 3 does not preclude tax credits from being used to reduce a tax debt. If that is the policy intention, why does the legislation not clearly state as much?
- 3.1.11. Para 2.14 of the response document states that 'HMRC will have clear operational criteria for when such set-offs would take place'. But this seems like another case of legislation being widely-drafted then interpreted via HMRC's guidance. It leaves little protection for the taxpayer to protest against their tax credits being offset against a tax debt; after all the courts only recognise the law not HMRC guidance. If HMRC are committed to not offsetting tax credits against other tax debts, then this should preferably be incorporated in the legislation. Alternatively, a clear Ministerial statement must be made as to intended use of the provisions, to provide purposive guidance to the courts in the event of a dispute.

Charitable assignment

- 3.1.12. On a similar note, the response document outlines at para 2.17 that a taxpayer's assignment to charity of a self-assessment repayment will be honoured and such repayment will not be considered for set-off. But there appears to be no provision for this in the legislation itself, with Section 3(7) 'disregarding *any* assignment of the person's entitlement to the sum'.
- 3.1.13. Again, this exception should be legislated rather than relying on HMRC's operational guidance.

¹ <http://www.hmrc.gov.uk/leaflets/cop26.pdf>

General comments on assignment

3.1.14. Clause 3(7) raises other concerns. Presumably a bank's lien on money coming into a person's account to clear a debt to the bank would operate as an 'assignment' for this purpose. Therefore, this overriding provision could be construed as an attempt by HMRC to reinstate Crown preference in bankruptcy situations. We understand that HMRC are considering this issue and intend to insert a further clause to cover insolvency and bankruptcy, but this is as yet unpublished.

3.2. *Functionality of set-off provisions*

3.2.1. As the provisions are currently drafted, HMRC has full control over

- whether set-off is to apply and against what; and
- in what order this is to apply.

We strongly believe that there should be a review of common law principles (and, in turn, HMRC's current practices) allowing the taxpayer the right to request that offsetting is applied. Clear guidance on this issue must be provided to the public.

Order of set-off

3.2.2. There is no mention in the draft legislation of the order in which set off will be applied. HMRC will have discretion as to its application, so presumably will decide how it is to apply on a case-by-case basis. This could operate to the taxpayer's disadvantage in some situations, depending on what is owed, whether interest is running and what surcharges or penalties could be incurred.

3.2.3. The legislation must therefore:

- be clear that the set-off provisions will operate to produce the most favourable result for the taxpayer; and
- incorporate a specific right of appeal against the set-off, for example giving grounds for appeal where the taxpayer believes that a different order of set-off would be more advantageous.

Operation of set-off

3.2.4. We still have reservations about the operation of set-off in practice. From discussions with the Powers review team, we understand that it will be a manual process initially, with the possibility of automation in future.

3.2.5. Our concerns stem from the limitations we know to exist in HMRC's systems. For example, the PAYE system is only now being brought into up-to-date so that an officer of HMRC can see a person's multiple sources of PAYE income from one location. So how is it proposed that set-off will operate, which requires a single officer (or automated system) to look at – and correctly interpret – all the various tax records applicable to a single person or even related entities to determine an offset? This means that the systems will have to interlink. Can HMRC provide explanations of how this will work, together with assurances that it has been tried, tested and proven in advance of implementation? As above, a right of appeal is essential, both against the exercise of HMRC's discretion to use set-off, and against the manner in which it is used (eg the order of set-off).

- 3.2.6. We are strongly of the view that HMRC should consult further on the concept of 'related entities' when they have formed a view of how these should be defined.

Effective payment date and taxpayer election

- 3.2.7. The response does not appear to address how the effective date of payment will be judged when the set-off provisions are applied – this is an important consideration for calculating interest and surcharges, for example. If this point is not to be addressed in the legislation itself, we would stress the need for HMRC to consult on draft operational guidance in due course.
- 3.2.8. Taxpayers require a clear explanation of how the provisions will operate. Take the example of Mr X, a self-employed VAT-registered trader, who is having trouble with cashflow. He is waiting for a VAT repayment as at 28 February and at the same time, his 31 January self-assessment liability is overdue. Can he assume that he will not be issued with a surcharge, as if you net-off the two sums, he actually owes nothing or is in an overall repayment position? Presumably the answer would be 'no', if HMRC have not exercised their discretion to apply the offset.
- 3.2.9. The legislation in its current form confers all the power onto HMRC. Taxpayers' rights to request set-off should also be made clear and to what extent they can expect it to apply automatically in circumstances such as those described above. Whilst a right to request set-off may exist in common law, taxpayers are likely to be ignorant of it. Clear and accessible guidance on the subject is essential. For instance, why is an option to offset not listed on HMRC's website under the 'How to pay' sections?

Communication

- 3.2.10. We reiterate from our previous response that if set-off is to function smoothly, HMRC must be able to communicate to the taxpayer what is happening. This will necessitate:
- warning the taxpayer that set-off could be applied, and in what circumstances;
 - explaining to the taxpayer in a clear and comprehensible manner when, why and how the set-off has taken place;
 - informing the taxpayer of any right to object to or appeal the set-off (including advice concerning HMRC's internal review system, assuming this is implemented in the tribunals reform process).
- 3.2.11. There is nothing in the draft clause to compel HMRC to tell the taxpayer about the set-off. Again, we strongly believe that a requirement to do so should be incorporated in legislation, rather than being confined to operational guidance; the latter being something which may be readily changed and which is unenforceable through the courts if HMRC depart from it.

4. Credit cards

General comments

- 4.1. In our response to the 25 June 2007 consultation, we were cautious about the extension of credit card payments to direct tax liabilities without a prominent 'health warning'. We welcome the recognition in the response at para 2.22 that HMRC must

include safeguards. These statements must now be reinforced with:

- clear operational guidance and training for those working in the debt management arm of HMRC; and
- clear, plain English warnings on statements offering the facility to pay by credit card.

HMRC should consult on the wording of these before the facility is introduced and we understand that this is indeed their intention.

Draft legislation

- 4.2. Section 4 ought to make it clear that the fee charged to the taxpayer cannot exceed (and could be less than) the fee charged to HMRC.
- 4.3. We also object to Section 4 being far too widely drawn, anticipating that it could be used in future to introduce charges relating to more traditional methods of payment, for example to pass on cash- or cheque-handling charges. Particularly for those on low incomes, these facilities remain important. These should therefore be expressly excluded from charge in the legislation.

5. PAYE collection

- 5.1. We can only reiterate the comments we made in our response to the 25 June 2007 consultation; that the concept is reasonable but various concerns remain, including:
 - the extent to which HMRC will warn people in advance what is going on and make it clear that they do not have to accept this treatment;
 - clarity of explanations that will be given to the taxpayer – a clear statement must be made on the P2 Coding Notice of how the underpayment has arisen; and
 - how the system will be made to operate in practice.
- 5.2. With the current upheaval in the PAYE system to provide the new 'PAYE service' and the possibility of payrolling benefits in kind (under separate consultation), it is likely that adding a further burden at the present time would be an unwelcome step. Once these issues have been addressed, we can see some merit in flexible debt collection via PAYE; for example, for someone who switches from self-employment into employment where there is a balancing self-assessment liability.

6. Further work

- 6.1. We assume that HMRC will issue consultation on this proposed further work in due course. We would particularly like to see flexible payment schemes given further serious thought as we feel these could be of benefit to low-income taxpayers struggling to budget for self-assessment liabilities.

LITRG
5 March 2008