

LOW INCOMES TAX REFORM GROUP

Interest – Working Towards a Harmonised Regime RESPONSE TO HMRC CONSULTATIVE DOCUMENT

1. Introduction

1.1. *About us*

- 1.1.1. 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.
- 1.1.2. 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.

1.2. *Concurrent consultations*

- 1.2.1. We are also submitting responses to the concurrent consultations on 'Payments, Repayments and Debt' and 'Meeting the Obligations to File Returns and Pay Tax on Time'. Many of the points raised below interlink with those consultations and our responses to them.

1.3. *General comments*

- 1.3.1. The consultative document entitled 'Summary of responses and proposals' reflects many of our comments made both in writing and at meetings.
- 1.3.2. The commissioning of research on tax debtors (para 1.6) is interesting and a good idea by HMRC.
- 1.3.3. We continue to endorse the overall principles for proceeding with the reforms and the recompense, fairness and simplicity drivers (Chapter 2), but highlight below where the final recommendations depart from them.
- 1.3.4. In general we support the proposals within the consultative document but we do have concerns over:

- whether the proposals will give proper restitution to taxpayers for HMRC error, and
- whether the differential interest rates are fair to taxpayers,

and develop these points further below.

2. Chapter 2 – The existing regime

2.1. Collection methods – interest variations

2.1.1. Para 2.3 suggests that variations exist in the current interest system ‘depending on the tax to which it relates’. We noted in our previous response to the interest consultation¹ that there are also differences (and potential unfairness) depending on the method of assessment and collection.

2.1.2. For example, we contrasted the position of a PAYE taxpayer having arrears collected via an adjustment to their code as against an ITSA taxpayer who has to negotiate time to pay to clear arrears: the former does not pay interest, but the latter does despite potentially being in a similar position.

2.1.3. We are not suggesting that the PAYE taxpayer should suffer interest on the overdue tax, but recommend that HMRC consider suspending interest charges in certain cases where a time to pay agreement is necessary to clear arrears. Suspension could be considered in cases of extreme hardship or exceptional circumstances, and where the tax system has dealt unfairly with the taxpayer. One example of this would be where a state pensioner has to pay tax via ITSA because he/she has no (or insufficient) source of PAYE income against which to collect any tax on the state pension – a situation which would not arise if PAYE were operated on the state pension as it is for other pensions.

2.1.4. This fairness issue will be further highlighted if the proposals to collect more small debts via PAYE goes ahead, as suggested in the concurrent ‘Payments, Repayments and Debt’ consultation.

3. Chapter 3: Harmonising interest: the next phase

3.1. Simple interest

3.1.1. As noted in our previous response, although it does not entirely achieve commercial restitution, we agree with the conclusion in paras 3.3 to 3.5 that a simple interest calculation should be adopted for the basic regime.

3.2. The starting point for the interest rate formula

3.2.1. Regarding the comments at para 3.8, the economic climate has deteriorated rapidly in recent months, even when compared to last summer’s consultation. We have seen unprecedented changes in the Bank of England base rate, but these changes have not necessarily been passed on to customers of the High Street banks.

¹ <http://www.litrg.org.uk/reports/submissions.cfm?id=592>

- 3.2.2. That said, the Bank of England base rate remains a sensible starting point for setting HMRC's rates for the reasons previously discussed, such as that it is well-known to most people and changes are widely publicised.
- 3.2.3. However, now that the rate calculation for repayment supplements has produced a zero rate of return to individual taxpayers on overpayments, we feel there is some argument for the supplement rate to be collared (ie to impose a minimum guaranteed rate of, for example, 2%), rather than purely tracking the base rate. It seems unfair that taxpayers receive no automatic recompense for a tax overpayment or missed claim.
- 3.2.4. In terms of timing, we accept that rate changes should be made in line with base rate announcements. However, for the sake of simplicity, HMRC's rates should change on a set date in a month (say the first or the sixth) to counteract the potential for more frequent changes in times of economic unrest, which would in turn ease the calculations.

3.3. ***Service standards and complaints – links to HMRC Charter***

- 3.3.1. As previously raised, we believe there are issues in terms of the restitutorial aspect of interest that are closely linked to HMRC's customer service, and hence to the proposed Charter. We will respond separately to the latest consultation on the Charter, but reiterate the following points on complaints, service standards and where HMRC's processes disadvantage certain groups of taxpayer.

Restitution in cases of HMRC error – complaints

- 3.3.2. In our response to the last round of consultation, we commented on the need to ensure that taxpayers can seek restitution from HMRC in cases of error or unreasonable delay.
- 3.3.3. Para 3.13 notes that 'customers can in fact already ask HMRC to consider reimbursing them for an actual financial loss arising directly from HMRC error or unreasonable delay'. But we would still argue that the existing process is inadequate. For example:
- Some taxpayers would not lodge a complaint due to fear, or ignorance that they can complain (following the age-old assumption that HMRC are always right).
 - The complaints process is slow and produces inconsistent results.
 - The taxpayer's loss might not necessarily be financial and as noted below consolatory payments for extra administrative burden are usually not reflective of the true cost of lost time; or the taxpayer might not be able to provide clear evidence for a financial loss, for instance where potential earnings were lost due to wasted time rather than a direct incursion of additional costs as a result of HMRC's error.
 - Guidance for lodging a complaint – now in the form of a short factsheet¹ replacing the previous Code of Practice (COP1) – is inadequate.
 - HMRC's system of compensating liquidated loss/damages, and paying a consolatory sum to recognise anxiety or other forms of emotional distress, does not (and is not intended to) put people back in the position they would have been in had HMRC's error or delay not occurred; and it is only in very

¹ <http://www.hmrc.gov.uk/factsheets/complaints-factsheet.pdf>

limited circumstances that HMRC can be sued for negligence.

- 3.3.4. Returning to the issue of differential rates (on which we comment further below), a taxpayer receiving a supplement on a delayed repayment might have incurred a much higher rate of interest on bank borrowings in the meantime. As a minimum, we recommend that HMRC's policy for reimbursement of the taxpayer's actual loss in such circumstances be set out in a clear Code of Practice to provide a more robust safeguard.

HMRC's service standards and processes

- 3.3.5. We would reiterate recommendations from our previous response regarding repayment claims¹. For example, we discussed the position of, say, taxpayers who file repayment claims using the R40 system, who are potentially disadvantaged by having to wait longer for a refund than ITSA filers, as there is no online R40 facility. No interest is paid if the claim is settled before 31 January following tax year end (as would continue to be the case according to the draft Schedule 2, Part 3, Para 11), yet the taxpayer has still lost out through HMRC failing to offer them the same level of service as an ITSA counterpart.
- 3.3.6. Also, as there are no published service standards by which HMRC must abide, how is a taxpayer to argue what constitutes an 'unreasonable delay'? We think this is an area where a proper service standard is needed.

3.4. **Differential rates**

- 3.4.1. We note that para 3.20 dismisses the possibility of mirrored rates of interest on both underpayments and overpayments. We reiterate our arguments in favour of mirrored rates below, but would stress that if there is to be a differential, it should be as narrow as possible.

HMRC is not a commercial organisation

- 3.4.2. HMRC do not have a commercial function of lending or borrowing so there is no prima facie justification for differential rates – HMRC do not have to make a profit out of the taxpayer. The principle is that HMRC should receive restitution for being deprived of the money (as should a taxpayer).

Arbitrage

- 3.4.3. Regarding para 3.16, why do differential rates discourage arbitrage between tax and non-tax debts? If late payment of tax debts is attended by additional penalties (as is likely for any significant delay in payment) as well as interest, HMRC are in fact likely to be favoured in the creditors' market. And even under the proposed interest regime, arbitrage/use of HMRC as a 'bank' is still likely to occur amongst those larger companies and institutions where significant sums are at stake; e.g. HMRC will be charging simple interest compared to probable compound charges on commercial borrowing.
- 3.4.4. Arbitrage is therefore unlikely to be eradicated and an inevitable part of a 'one size fits all' interest regime, particularly if HMRC are truly seeking fairness and restitution. If HMRC want to introduce higher interest rates for unpaid tax to deter late payers, or lower interest rates for overpaid tax to deter arbitrage, then they are departing from

¹ See paras 3.5ff <http://www.litrg.org.uk/reports/submissions.cfm?id=592>

the principles of fairness and restitution on both counts. It must also be borne in mind that taxpayers are not all in the same position – a large business may have access to funds at much lower cost than a low-income taxpayer.

Interest should be restitutive not punitive

- 3.4.5. Para 3.18 states that 'Feedback from those interviewed as part of the Ipsos MORI research supported the view that interest rates should be comparable with bank rates to discourage late payment of taxes to gain a financial advantage'; yet earlier comments assert that HMRC intend interest to be purely restitutive and not punitive. We would in many ways echo this – we agree that the interest rate charged on late payment should make delaying tax payment something other than an easy option. But the aim of the current reforms must be to get a balanced package that produces a fair system for all, as far as possible.

3.5. **PAYE**

- 3.5.1. As recommended in our earlier submission, an extended P35 arrangement appears to be the most practical way forward as a means of assessing interest and penalties on late payments of in-year PAYE.
- 3.5.2. Our main comments on the proposals are contained within our response to the concurrent consultation 'Meeting the Obligations to File Returns and Pay Tax on Time'. However, we would comment here that we understand HMRC intends, when reviewing the 12 monthly analysis against payments made, to look also at overpayments when assessing the interest; so they would pay interest on any amounts overpaid or paid early as well as charging interest on amounts underpaid or paid late. The consultation document as it is written does not give this impression.

De minimis for small employers

- 3.5.3. We discuss this in our response to the penalties consultation, but particularly point out here our concern for 'accidental employers' such as those in receipt of Direct Payments engaging the services of a carer¹. We understand that a separate consultation dealing with employer/PAYE issues in such cases is planned. We believe that the Impact Assessment as it stands has not fully considered the position of this sector and further work is needed in this area.

3.6. **Special circumstances**

CTSA / ITSA

- 3.6.1. Regarding the comments at para 3.29, we remain unconvinced as to the reasons given for maintaining a difference between CTSA and ITSA, which suggest that interest on the former should continue to be backdated to the date of payment rather than the eventual due date of the tax. The consultation states: 'The current payment of interest on corporation tax payments back to the date paid reflects the fact that corporation tax payments fall due before the known liability is brought into charge.' But surely ITSA is the same in so far as the first payment on account is due on 31 January before the end of the tax period?

¹ See our report: Independent living, direct payments and the tax system
<http://www.litrg.org.uk/reports/reports.cfm?id=490>

- 3.6.2. Although the amounts involved may be larger for companies, small amounts may be significant for individual taxpayers, particularly those on low incomes. It seems that HMRC are content to depart from the principle of alignment in this case (also continuing with the principle that corporation tax rules on deductibility of interest under the loan relationship rules will remain out of kilter with the equivalent rules for individuals), yet do not acknowledge that special circumstances exist in cases such as inheritance tax, as highlighted below.
- 3.6.3. We question whether this asymmetry between corporate and non-corporate entities meets the principle of fairness, even if it is simple, as the corporate body benefits from a lower effective tax rate than the individual through deduction against profits of interest charges incurred.

Inheritance Tax

- 3.6.4. The consultation document does not acknowledge our earlier call for Inheritance Tax interest charges to be considered separately. We are aware that our CIOT colleagues are also suggesting that IHT be considered a special case and support their recommendations.
- 3.6.5. We therefore reiterate the comments we made at para 4.7ff of our previous submission¹ and recommend that IHT rates be subject to further consideration, rather than aligning them with other rates purely for the sake of alignment.

4. Draft legislation

4.1. Rates of interest

- 4.1.1. We would mention one point in relation to Clause 6. Understandably, the Treasury is being given powers to set interest rates by statutory instrument. That is only sensible. But given the discussion and broad agreement as to how those rates should be determined, we would have expected the statute to say that the rates will follow Bank of England base rates. We cannot see any valid reason for not specifying that.
- 4.1.2. We accept that regulations can be allowed to specify the exact timing, nevertheless legislation presumably could dictate that the changes should be effective, save in special circumstances, on (say) the first of the following month.

LITRG
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¹ <http://www.litrg.org.uk/reports/submissions.cfm?id=592>