

## **How to improve HMRC's collection of debt: coding out**

### **HM Revenue & Customs (HMRC) consultation**

### **Response by the Low Incomes Tax Reform Group (LITRG)**

#### **1 Our response**

- 1.1 We are responding to this consultation with the specific interests of low-income workers in mind.
- 1.2 In principle, we are in favour of tax debts being paid as soon as possible: this is in the interest of the wider community. Nevertheless we do have concerns that in some cases the financial security of low-income workers might be compromised by these proposals.

#### **2 Executive Summary**

- 2.1 We agree that collection of larger debts via coding out is a good idea in principle, particularly in cases where the alternative would be collection through self-assessment.
- 2.2 However, PAYE underpayments and other debts may arise for a variety of reasons, many of which are outside the taxpayer's control. Great care must be taken when coding out large numbers of debts if a taxpayer is on a low income, bearing in mind the tax debt may be only one of a number of debts and the taxpayer may face uncertainty in employment and in their life generally.
- 2.3 For someone earning substantially less than the national average wage, a payment of £250 per month (arising from collection of a £3,000 tax debt) could be extremely damaging to their financial wellbeing and we would strongly support the ability to collect such debts over more than one tax year.

- 2.4 We are concerned that some low income taxpayers, among others, might not understand the implications of different methods of debt payments and communication with them will be crucial. Each and every debt needs to be separately identified by narrative so that the taxpayer can track what debts are owed and how they are being repaid. Only debts that have been accepted as being payable should be able to be coded out. This process must include proper communication and a robust and easily accessible appeal process. No debts should be coded out while the quantum or indeed the existence of any liability remains in dispute. HMRC must apply the debt in the most favourable way to the taxpayer and produce statements for the taxpayer confirming this point.
- 2.5 Further consideration should be given to debts that are coded out in the first instance where subsequently the taxpayer leaves the PAYE system or takes on a job with substantially reduced pay.
- 2.6 The PAYE system already struggles to cope with multiple employments and is inflexible as regards recognising other losses or allowances of taxpayers that might be due in the current year to offset any past debt. If collection of debts via coding out is to become more prevalent, these issues need to be addressed.

### **3 About LITRG**

- 3.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 3.2 LITRG works extensively with HM Revenue & Customs 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.
- 3.3 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.

### **4 Detailed comments**

#### **4.1 *Comments on what comprises the debt***

- 4.1.1 We note that the word 'debt' is not defined in the consultation document. Given the possibility of substantial debts being recovered by the coding out process, we consider that this should be addressed as soon as possible. HMRC have gradually increased the types of debt that might be coded out - as from October 2013 both Class 2 NI and share fishermen debts are included in the class of 'relevant debt' that may be coded out, presumably with plans to include more debts in the future.

- 4.1.2 S110 and Schedule 58 FA 2009 currently show that ‘relevant debts’ may be collected in this way and regulations have been used to define what a ‘relevant debt’ is.
- 4.1.3 We note from the Consultation Document – ‘Simplifying the National Insurance processes for the self employed’ that a significant amount of Class 2 debt is considered to be overstated and we urge HMRC to ensure that the Class 2 debt that it pursues has been agreed to be payable. This might be particularly relevant for individuals who registered for self employment, but for one reason or another never actually began trading. Indeed one reason might possibly be because they accepted a position as an employee.
- 4.1.4 It appears that there is currently no statutory time limit on when a debt might become a relevant debt. For example, a balancing payment not paid on 31 January 2014 could be included almost immediately in a taxpayer’s Notice of Coding. We would support a six month period during which other payment arrangements might be negotiated before automatic coding out took place.
- 4.1.5 At point 2.3 in the Consultation Document, the implication is that the debt might include both penalties and interest. Currently no interest is normally charged on PAYE underpayments that are coded out and we are concerned that a change of practice may be being considered. Certainly clarity is needed in this area since PAYE underpayments and other debts may arise for a variety of reasons, many of which are outside the taxpayer’s control.

#### 4.2 ***Communications and Appeal process***

- 4.2.1 The taxpayer needs to clearly understand what his tax debt is and how it has arisen. One word or phrase on a Notice of Coding is totally inadequate in these cases. Each and every debt needs to be separately identified by narrative so that the taxpayer can track what debts are owed and how they are being repaid. This becomes even more important if debts are to be collected over longer periods as it will enable the taxpayer to track progress.
- 4.2.2 Having been told what the debt is and a full explanation given, there needs to be a proper appeal process in place for the taxpayer, and one that the taxpayer can easily follow without the need for professional advice.
- 4.2.3 In addition, we would welcome reassurance that no debts would be coded out while the quantum or indeed the existence of any liability remained in dispute.

#### 4.3 ***How debt arises***

- 4.3.1 The ‘new’ penalties for late submission of tax returns have vastly increased the potential incidence and quantum of debt relating to penalties. Without a proper appeal system many taxpayers might find themselves facing significant debts being coded out before they have had the opportunity to properly dispute the incidence of the penalty or the amount.
- 4.3.2 For PAYE underpayments, for example, the taxpayer’s employer may have made a mistake, coding errors may have been made by HMRC or the PAYE system itself may have inherent flaws such as the Week 53 system.

- 4.3.3 One of the common errors affecting pensioners is the incorrect operation of PAYE coding in relation to receipt of the state pension where there appears to be inadequate sharing of information between DWP and HMRC.
- 4.3.4 Where the taxpayer's employer or pension provider has made the mistake, then the correct procedure is to collect the debt via a Regulation 72 assessment on the employer/pension provider rather than attempt to collect the debt from the employee or pensioner, and only to have recourse to the employee or pensioner in the limited circumstances set out in that regulation.
- 4.3.5 In other cases ESC A19 might be in point and the whole debt might not actually be due from the taxpayer.
- 4.3.6 We note the penalty regime is used more commonly in some areas of taxation than in others. We would not wish this proposal to change existing practice on the charging of penalties to the taxpayer's disadvantage.

#### 4.4 ***Payment of debt***

- 4.4.1 Given that a taxpayer might have more than one debt being collected in this way, we seek reassurance that HMRC will apply the debt in the most favourable way to the taxpayer and that it will be able to produce statements for the taxpayer confirming this point.
- 4.4.2 We recognise the value of the work carried out by the Business Support Service, but it is restricted to taxpayers who approach them in advance of a debt becoming payable. Many low-income taxpayers will not be aware of this facility and accordingly will be unable to take advantage of this service.
- 4.4.3 We note the proposal to introduce an automated telephone service for debt payments. We would emphasise that this needs to be a free number, or it will add to potential debts, and also point out that this service may well remain unavailable for many disabled or elderly people. In addition, many of the lowest paid workers do not have credit cards (that would prove costly to use) and may also be reluctant to provide HMRC with card details, in any case. If such an automated system is introduced, we recommend that it contains a warning regarding the payment of debts via credit cards so that those taxpayers who are not financially astute do not end up in a worse overall position than they were in before.
- 4.4.4 For low income taxpayers, many of whom are unrepresented, we consider that the information provided to them regarding payment options is crucial. As noted above, many might not understand the implications of making a payment via credit card, ie that the debt incurred on the credit card will accrue even more debt, thus escalating the problems of a vulnerable taxpayer. Further, the more options that are made available, the more difficult it might be for a taxpayer to make the most suitable choice.
- 4.4.5 Other agencies may also find it difficult to advise in these circumstances, although in principle we welcome a taxpayer having options of how to pay their debts. In this connection we note that at 3.9 in the Consultation Document it is stated that SA taxpayers cannot object to having the debt included in their code, unless they make other arrangements to pay. As noted above, we consider it essential that there is a proper appeal process in place for taxpayers and that silence does not

constitute acceptance. We would emphasise that some vulnerable taxpayers may be SA taxpayers, but due to changes in circumstances might now find it difficult to have debts collected via coding out. Identifying these taxpayers may be difficult, but we consider it to be essential.

4.4.6 We have previously suggested the implementation of tax savings accounts for individuals that might work in a similar way to certificates of tax deposit, but with much smaller sums. For low income taxpayers these could be of significant help, especially where the taxpayer may be paid at irregular intervals and thus have to work with differing amounts of net pay on a weekly/monthly basis.

4.4.7 While we accept that HMRC have processes in place to safeguard taxpayers who may be experiencing financial difficulty, the comment that the taxpayer should seek help from HMRC is less helpful. Many low-income workers are scared that making an approach to HMRC might bring their file 'to the top of the pile' and for migrant workers, this is especially so.

#### 4.5 ***Other issues***

4.5.1 In general we welcome the decision to group taxpayers based on their own characteristics and past behaviour rather than on the types of tax they pay. Low-income taxpayers often have many characteristics in common: less able to access help via the internet or telephone (due to age, disability or low income); less able to access help from professionals (due to age, disability, ability to pay professional fees or language issues); less able to pay.

4.5.2 While HMRC have procedures in place to protect some vulnerable taxpayers, this relies on information being available to HMRC and, for some of the reasons noted above, it is possible that HMRC will not have full information. Protecting these vulnerable taxpayers is important.

4.5.3 Some of these vulnerable taxpayers will also lead chaotic lives with several house moves in a year. Informing HMRC of their current address may not be a high priority, so they may not receive any communication from HMRC regarding an underpayment until their first pay day using a new code number. Such individuals need to have the ability to query that code number, if they have not previously had that opportunity.

4.5.4 In the current economic client, many low-income families will have found difficulty in meeting their financial commitments. Where a tax debt has arisen, this may be only one of a number of debts faced by the taxpayer. We do have concerns that increasing the sums to be collected by PAYE will, in fact, prejudice other creditors and so may prove more detrimental to vulnerable taxpayers. For example, the taxpayer may find themselves unable to meet food or utility bills as a result of this debt collection.

4.5.5 In addition, many individuals are having to work reduced hours or are losing their jobs altogether. There is no mention in the document about any action that might be taken in the event the taxpayer becomes unemployed and is unable to pay the debt via PAYE. This point requires clarification.

4.5.6 It is also not clear how the amount of debt to be coded out will be applied to taxpayers whose earnings fluctuate. This might be due to payment of bonuses (for the more fortunate), or because of zero hours contracts (for the less fortunate). A taxpayer might have a well paid job at the time the coding notice is first issued, only to have to accept a much lower paid job later in the year.

- 4.5.7 Our understanding is that Universal Credit (UC) will be based on an employed earner's net earnings as reported through RTI. The effect of this is that the coded out debt will reduce the taxpayer's net income and increase any UC payable to him.
- 4.5.8 The collection of debt via PAYE also fails to take account of other income or losses of the taxpayer. For example, a self employed person who has decided to seek employment because their business is performing poorly, may not be able to quantify any loss relief available for the year in question, but may suffer considerable hardship because of a tax debt being coded out. The self assessment system does not allow such losses to be recognised before the relevant tax return is lodged, but in the case of such hardship, perhaps some mechanism requires to be found.
- 4.5.9 We note that in 15% of cases, PAYE will not collect the correct amount of tax. No statistics are provided of the proportion of those cases that result in repayments being due. We would urge HMRC to ensure that refunds are dealt with quickly. Further we would suggest that refunds due, particularly those that might otherwise be refunded through payroll, might be considered for set off against any debts that have accrued, but always subject to the debt and this method of payment being agreed by the taxpayer.
- 4.5.10 It is noted in 3.13 of the Consultation Document that the individual may be able to pay back tax for earlier years. Our understanding was that where the underpayment had arisen due to HMRC error or failure to make use of information in their possession, then ESC A19 may be relevant to restrict the debt to be collected.
- 4.5.11 In principle, we agree that higher earners might benefit from having larger tax debts coded out as the alternative would be a one-off payment.
- 4.5.12 The Office for National Statistics provided a report in November 2012 (Annual Survey of Hours and Earnings, 2012 Provisional Results) showing that the average full time salary in the UK in the year to April 2012 was £26,500. This is an average figure and we would emphasise that a significant number of workers earn substantially less than this. For such an individual a payment of £250 per month (arising from collection of a £3,000 tax debt) could be extremely damaging to their financial wellbeing and we would strongly support the ability to collect such debts over more than one tax year.
- 4.5.13 While we accept that coding out remains a valuable option for collecting debts, we recognise that the system of coding out is poorly understood by taxpayers. We would urge that explanations and reconciliations need to be made to taxpayers on a regular basis so that they understand the process.
- 4.5.14 We also recognise that coding out can be a useful tool to ensure taxpayers remain outside the Self Assessment system (SA), for many of whom the burden of complying with SA would prove extremely difficult. As we have noted before, certain pensioners might benefit from having deductions of more than 50% from a particular source of income in order to allow them to stay outside SA. Would it be possible for such taxpayers to 'opt in' for a higher tax charge on a source of income?
- 4.5.15 Another issue that commonly arises is where a taxpayer has more than one job. How will the collection system operate in these circumstances?

- 4.5.16 Current practice is that coding out a debt takes place over a whole tax year. Other items, eg car benefits, can be included in coding notices for, say, the last six months of a tax year. We suggest the system might benefit from more flexibility.
- 4.5.17 This flexibility could be best used where underpayments are identified early in the reconciliation process and so there is a significant amount of time for the debt to be communicated and agreed.
- 4.5.18 Coding out remains a valuable option, but many low income taxpayers do not have one regular source of income: they may have one job that pays differing sums depending on hours worked or have more than one job or move in and out of employment on a regular basis. It is not clear how these cases will be dealt with.

## **5 Responses to the Particular Questions raised**

### **5.1 *Q1 Are the graduated coding out limits for debts and tax repayments recommended for those on incomes of £30,000 or above set at the right level?***

- 5.1.1 Our comments above note that for a taxpayer earning £30,000 a year, payment of £250 per month for a debt might prove onerous. This might be the case particularly if this were a family with a number of children. Accordingly we suggest that the increased limits be applied at a higher income level.

### **5.2 *Q2 Does the proposal not to change the coding out limits for those with incomes of less than £30,000 adequately safeguard those on lower incomes?***

- 5.2.1 In the current economic climate, we suggest that the coding limit for those earning under £20,000 be reduced to £2,000 for a single year with any balance being collected in the subsequent year.

### **5.3 *Q3 Should the statutory safeguard to prevent PAYE deductions exceeding 50 per cent of an individual's relevant pay be extended?***

- 5.3.1 While from a question of practicality and expediency we understand the proposals to limit tax deductions to 50% of net salary, this does seem to protect disproportionately the highest earners, who currently may face significant tax charges at 40% and 45%. In addition, it is the very high earners who are most able to make a one-off payment via self assessment. We also note that some taxpayers may still prefer to have more than 50% deducted from their salary in order to take advantage of coding out. We suggest that in instances where a deduction might be more than 50%, the taxpayer be approached with options that might include a deduction of over 50% from a particular PAYE source. Our emphasis here is that the taxpayer should have the option, rather than any compulsory action being taken. In no circumstances should taxpayers on low or modest incomes be required to agree to a deduction of more than 50%.
- 5.3.2 In addition, we note that the experience of a 50% deduction from salary from a taxpayer earning £100,000 is very different from that of a taxpayer earning less than £30,000 a year where the effect of such a deduction might be catastrophic.

5.4 ***Q4 In circumstances where a debt cannot be collected via the tax code in one year, do you agree that HMRC should use existing powers to code out part of that debt?***

5.4.1 We agree that where the whole debt may not be collected in one tax year, HMRC should use existing powers to collect part of the debt. In principle, we would support debts being collected via coding notices over more than one year.

5.5 ***Q5 Do you have any comments or suggestions on the indicative impacts identified in the table of impacts?***

5.5.1 The impact assessment at 3.39 indicates no change for 2013/4 or 2014/15. If larger underpayments for 2013/14, that would normally become payable on 31 January 2015, are coded out surely that will impact negatively on the figures as debt will be collected much later? Or does the comment at 3.29 instead mean that the new limits would start to collect underpayments arising from 2014/15 onwards only?

LITRG

3 September 2013