



TAXREP 47/13

(ICAEW REP 127/13)

ICAEW REPRESENTATION

HOW TO IMPROVE HMRC'S COLLECTION OF DEBT: CODING OUT

Comments submitted in September 2013 by ICAEW Tax Faculty to HM Revenue & Customs on the consultation document *How to improve HMRC's collection of debt: coding out* published on 11 July 2013

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document *How to improve HMRC's collection of debt: coding out* published by HMRC on 11 July 2013.
2. We should be happy to discuss any aspect of our comments and to take part in further consultations on this area.
3. We have previously taken an active part in consultations on proposals in the 'Payments, Repayments and Debt' work-strand of the Review of HMRC's Powers, in which the coding out of tax debts was one of the topics under consideration
4. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

5. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.
6. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.
7. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

8. Our key comments are:
 - We broadly support the proposals to make more use of coding-out to recover debts and underpayments, and to remove some of the current restrictions.
 - We think that the proposals should include more flexibility in the options available to the taxpayer. The taxpayer should have the ability to ask HMRC to override the limits – though HMRC should not have the power to override limits without the taxpayer's agreement. There are also situations in which HMRC must exercise discretion. Our answers to the consultation questions include further details and suggestions.
 - The proposed changes introduce a wider range of ways to recover tax debt, which could be confusing for the taxpayer. It is therefore important that HMRC can give taxpayers clear guidance and information about the actions being taken, the options open to them and the consequences.
 - HMRC should consider the option of changing the PAYE code part-way through a year.
 - In the interests of clarity HMRC should make 31 December the filing deadline to get coding-out treatment for SA underpayments.
 - The consequence of RTI should be considered, including the need for any additional safeguards for taxpayers.

- We support the proposal that those on higher incomes should be able to have larger amounts of debt coded out, and accept that a graduated scale is the simplest method of establishing limits.
- We would welcome clarification that 'earnings' includes both cash payments and benefits-in-kind.
- Those with higher earnings will not necessarily have larger amounts of disposable income, so in appropriate cases HMRC should have the flexibility to apply a lower limit for coding out than that prescribed in the graduated scale.
- We question why the graduated scale of limits is being based on the primary PAYE source of income alone rather than on the total PAYE income. This could lead to anomalies and cause confusion.
- We welcome the extending of the 50% regulatory overriding limit for K codes to all tax codes.
- In some cases the 50% limit can be too restrictive, and we think that it should be possible to override it and deduct more if the taxpayer wishes.
- We support the proposal to code out the first £3,000 of a debt and then collect the balance separately.
- We also recommend that HMRC should be able to code out £3,000 in one year and the balance the following year.

GENERAL COMMENTS

9. We broadly support the proposals to make more use of coding-out to recover debts and underpayments, and to remove some of the current restrictions. We have concerns or questions about some aspects of the proposals as set out below.
10. In addition to answering the specific questions in the consultation, we have some comments about other aspects of debt recovery and coding-out.

Importance of flexibility

11. We think that the proposals should include more flexibility in the options available to the taxpayer. For example, a taxpayer might prefer to have a higher amount of debt coded out than the graduated scale of limits or the 50% override permits. The taxpayer should have the ability to ask HMRC to override the limits – though HMRC should not have the power to override limits without the taxpayer's agreement. Conversely, HMRC must exercise discretion where, for example, applying the maximum figures given by the graduated scale would cause hardship. Our answers to the consultation questions include further details and suggestions.

Safeguards and guidance for taxpayers

12. The proposed changes to the coding-out rules, coupled with our suggestions for increased flexibility, introduce a wider range of ways to recover tax debt and options for the taxpayer. One consequence and potential drawback of this is that taxpayers could be confused and have problems understanding both how their debt is being collected and their PAYE codes. This is more likely to be a problem for unrepresented taxpayers.
13. It is therefore important that HMRC can give taxpayers clear guidance and information about the options open to them and the consequences. Where HMRC is using its powers to code out a debt (rather than at the taxpayer's request or with their agreement) it is equally important that HMRC gives clear information about the actions and their consequences. This should include information about what to do if they have financial difficulties which mean the debt recovery action should be reconsidered.

14. As a specific example, HMRC does not give any indication on tax coding notices what the effect of the change will be on net pay. Given this, taxpayers may be unaware of whether or not the repayments will be affordable until after the first use of the tax code, and most taxpayers do not understand how to estimate their tax and NIC, and thus net pay, from a coding notice. HMRC should make it very clear what the reduction in net pay will be as a result of the tax code change.
15. At para 3.20 it is stated: 'Once it has been set up, the debt due is recovered automatically via PAYE with no need for further intervention by HMRC'. We think this over-states the position – the whole of the debt will not necessarily be collected if there is a break in employment, or if there is a tax code change which results in a non-cumulative code, or if earnings fluctuate widely. These issues should be made clear to the person owing the money otherwise their expectations of having repaid the debt after a year will be misplaced.

Changing the code at the start of the year

16. HMRC states (para 3.5) that where a debt is included in a tax code, this will always be done from the start of the tax year. We are not sure of the reasons for this but think it may be for administrative simplicity, as suggested in the consultation document *Payments, Repayments and Debt: the Next Stage* (November 2008). The same document also noted that 'HMRC will continue to consider whether this could be extended to allow debts to be collected in this way throughout the year'.
17. We think this should be reconsidered to give the option of changing the PAYE code part-way through a year, so that a debt can start to be collected as soon as possible. Some taxpayers may prefer this. However, as a safeguard it should only be done with the taxpayer's agreement.
18. If a debt starts to be collected via PAYE part-way through a tax year, it should still be collected over 12 months (rather than just the remaining months of that tax year).

Tax return filing deadline for coding-out

19. SA balancing payments are automatically included in future tax codes provided the return is filed by 30 December, unless the taxpayer opts out.
20. We have long wondered why the deadline is 30 rather than 31 December. We are aware of some cases where the taxpayer or agents has been caught out because the deadline is not the last day of the month, and it appears that HMRC applies the deadline strictly. There has also been confusion because on occasion some of HMRC's own published material has shown 31 not 30 December as the deadline. We assume the 30 December deadline was originally set because of some administrative aspect of tax return processing, but filing procedures have changed since then.
21. We recommend that in the interests of clarity HMRC makes 31 December the filing deadline to get coding-out treatment for SA underpayments.

Collecting PAYE underpayment via SA

22. Para 3.15 states: 'A customer can contact HMRC if they do not want to have their PAYE underpayment ... coded out. However, the customer would have to ... submit a return under SA in order for the underpayment to be collected through the legal framework of the SA system'.
23. At the moment non-SA taxpayers who receive a P800 showing an underpayment are able to make a voluntary payment of the amount due without the need to enter the SA system.

24. We do not know if para 3.15 indicates HMRC is planning to make it compulsory to submit an SA return where PAYE underpayments cannot be collected via PAYE. If this is the intention, we oppose it; entering the SA system in order to settle a liability would be unnecessarily onerous for those taxpayers who do not otherwise meet the SA criteria. It could be particularly problematic for the unrepresented.

Impact of RTI

25. We notice that the consultation document does not mention the impact of the Real Time Information (RTI) system of PAYE reporting.
26. HMRC could use RTI data to determine a taxpayer's ability to pay a debt or underpayment on a month-by-month basis. This could affect an individual who became unemployed or otherwise suffered a big fall in income, so that a large underpayment in their code was no longer likely to be collected. HMRC would know this from RTI returns and could potentially remove the underpayment from the tax code and immediately ask for payment. Clearly where someone already suffering financial problems such a step would make the position worse. .
27. There need to be safeguards for taxpayers in this situations and we should be interested to hear HMRC's views.

RESPONSES TO CONSULTATION QUESTIONS

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

28. We support the proposal that those on higher incomes should be able to have larger amounts of debt coded out.
29. We accept that a graduated scale is the simplest method of establishing limits, both for administrative reasons and to enable taxpayers to understand the system. We note that it will produce 'cliff edges' but it hard to see how to eliminate these unless an alternative, more complex, method is used.
30. The income band in which a taxpayer falls will be based on earnings from the primary PAYE source (para 3.26). We would welcome clarification from HMRC that 'earnings' will include both cash payments and benefits.
31. Those with higher earnings will not necessarily larger amounts of disposable income to repay debts if, for example, they have substantial benefits-in-kind. In case where HMRC is using its powers to code out debt, it should in appropriate cases have the flexibility to apply a lower limit than that prescribed in the table.
32. Taxpayers in SA may have difficulties because the coding-out limits are applied with respect to their primary PAYE source but take no account of SA profits or losses. A taxpayer might find themselves repaying an SA balancing payment which arises from a previous, profitable trading year, while in the current year they have losses. If HMRC uses its power to recover the maximum debt under the graduated scale without taking account of the taxpayer's overall lower income due to the current year losses, the taxpayer could suffer financial difficulties.
33. We question why the graduated scale of limits is being based on the primary PAYE source of income alone rather than on the total PAYE income. We assume this is for reasons of administrative simplicity. However, this could lead to anomalies and cause confusion, as illustrated in this example:
 - Mr X has primary source income of £90,000. His limit will be £17,000.

- Mr Y has primary source income of £60,000 and secondary source income of £30,000. His limit will be £9,000.
- Mr Z has primary source income of £30,000 (such as a pension) and secondary source income of £60,000. His limit will be £3,000.

34. The current PAYE computer system should enable HMRC to have a complete picture of a taxpayer's PAYE sources. Limits for recovering debts and underpayments could be based on the total income and the debt allocated between the various PAYE sources, which would remove such anomalies.

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?

35. This proposal, coupled with the extension of the 50% of gross income restriction to all situations, will provide welcome safeguards.

36. However, coding out as much as £3,000 could be disproportionately harsh for those on low incomes, and HMRC must be aware of possible hardship situations and exercise flexibility.

Q3: Should the statutory safeguard to prevent PAYE deductions exceeding 50% of an individual's relevant pay be extended?

37. We welcome the extending of the 50% regulatory overriding limit for K codes to all tax codes, which is in fact something ICAEW has long recommended.

38. However, in some cases the 50% limit can be too restrictive. In some cases the primary source income is relatively small and the taxpayer would happily have virtually no net pay from that source because they have plenty of income from other sources. This happens, for example, to pensioners with several pensions and to higher-paid employees who have a small pension. Similarly some taxpayers would be happy to have tax deducted at 50% or more from subsidiary sources but the tax code system, as currently set up, cannot operate this.

39. Therefore we think that where a taxpayer would like more deducted from the primary source, or another source, this should be permitted. However, this flexibility should not be something HMRC could apply without the taxpayer's agreement.

40. The difficulty of recovering a debt or underpayment where the primary source is a small one would also be alleviated by basing the debt recovery limits on all PAYE sources, as suggested above.

41. In addition to the 50% restriction we understand there is a restriction in NPS whereby a coded underpayment is limited to the same amount as the taxpayer's normal PAYE tax bill. This did not apply to SA taxpayers prior to NPS being introduced. The problems caused by this restriction have been raised with HMRC most recently during the consultation on increasing the coding-out limit from £2,000 to £3,000.

42. We think that as the coding-out rules are being changed, this would be a good opportunity for making the necessary software changes to restore the status quo for SA taxpayers. If this is not done, there could be SA taxpayers who ask for their underpayment to be coded out only for it to be rejected.

43. The background to this restriction, as we understand it, is as follows:

- Prior to the changeover to NPS, the only coding restrictions on SA balancing payments were the monetary limit (£2,000 later increased to £3,000) and the 50% rule whereby the employer could not deduct more than 50% of the gross pay in tax.

- For PAYE only taxpayers there was also a hardship provision where, at the taxpayer's request, the coded underpayment could be limited to the same amount as the taxpayer's normal PAYE tax bill.
- When NPS was implemented this additional restriction, which had never previously applied to the coding of SA balancing payments, was hard-coded into the NPS software for all taxpayers. The manual section dealing with this restriction (PAYE 12071) says: 'When reviewing the tax due for the year do not more than double the individual's liability by including collection of an underpayment.' The section goes on to say 'The liability for the source against which the underpayment is to be coded should be considered in isolation; the individual's total liability from all sources should not be used to determine whether the underpayment can be coded.'

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?

44. We support this proposal. We feel it would make large debts far easier to cope with if HMRC would code out the first £3,000 and then collect the balance separately.
45. We also recommend that HMRC should be able to code out £3,000 in one year and the balance the following year.
46. HMRC is proposing to keep the £3,000 limit for all taxpayers for this purpose, or if the amounts in the graduated scale (para 3.28) would be used to establish how much of a debt could be coded out. We assume the latter, from the comments in para 3.38, but would welcome clarification.

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

47. No comments.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)