Summer Finance Bill – Direct Recovery of Debts

The Direct Recovery of Debts legislation (or, as the Finance Bill terms it, “Enforcement by deduction from accounts”) will give HMRC the power to recover certain debts direct from taxpayers’ bank accounts. Although the intention is that this will only be used to recover debts from those who have funds but who choose not to meet their tax obligations, it is a significant new power for HMRC, and it is important both that HMRC use it as intended, and that appropriate safeguards are put in place.

Direct Recovery of Debts (DRD) was first announced in the 2014 Budget, and was the subject of consultation during 2014. The legislation included in the Summer Finance Bill reflects some of the issues raised during this consultation process, although HMRC have not addressed all the points raised.

Aim of provisions

As confirmed in the summary of responses to last year’s consultation, published in December 2014, the intention is that: “DRD will help to level the playing field [between those who pay and those who do not]. It is a targeted measure that will affect a small number of individuals and businesses who are making an active decision to not pay, or delay paying, the money they owe – even though they have sufficient funds in their accounts”. The Tax Information and Impact Note published alongside the Summer Budget estimates that DRD will be used in some 11,000 cases each year, although will be used in a more limited way in 2015/16 to allow HMRC to, in effect, test the system on a small scale.

DRD in overview

The DRD legislation will allow HMRC to issue a ‘Hold notice’ to a bank or other deposit taker in respect of a taxpayer with an outstanding debt. The bank will then have to, in effect, freeze the relevant amount in the taxpayer’s account or accounts. The taxpayer has a period of 30 days to object (on which see more below). After this period, the bank can then be required to transfer the relevant amount directly to HMRC.

DRD can apply to ISAs and to joint accounts (although in the latter case there are restrictions on the proportion of monies in the account that can be subject to DRD). It cannot, though, apply to accounts in currencies other than sterling.

The DRD legislation, which does not apply in Scotland, will come into effect on the date of Royal Assent to the Finance Bill.

When can DRD apply?

The legislation provides that DRD can apply to amounts due either “under or by virtue of an enactment” (ie under the terms of the tax legislation) or “under a contract settlement” (for instance, with HMRC), but only when all of the following three conditions are met:

- Condition A – the debt is “at least £1,000”;
- Condition B – the debt is either due under the accelerated payments legislation, or is “an established debt”; and

- Condition C – "HMRC is satisfied that the person is aware that the sum is due and payable by the person to the Commissioners".

Of these, Condition A is straightforward, but there are elements of Conditions B and C that warrant further analysis.

An "established debt"?

An "established debt" is further defined as follows:

"A sum that is due and payable to the Commissioners is an "established debt" if there is no possibility that the sum, or any part of it, will cease to be due and payable…on appeal".

The legislation is explicit that this condition can equally be satisfied where no right of appeal exists, where an appeal has been made and has run its course, or where although the right of appeal exists, no appeal was made within the relevant time limits.

Significantly, this could include situations where, in the absence of a tax return, HMRC have made a determination of the amount of tax due, as there is no statutory right of appeal against determinations. An individual who does not submit a Self Assessment tax return could, therefore, find themselves subject to DRD where HMRC raise an assessment, even though the amount of the assessment might not be an accurate reflection of their true tax liability. Such a taxpayer would have twelve months from the date a determination is issued to displace it by submitting their own Self Assessment: there is, though, no requirement in the DRD legislation for this period to have expired before HMRC can apply DRD to the presumed debt. It is, therefore, to be hoped that HMRC will use this power sparingly in the case of determinations which could still be displaced, and that they take care that any determinations are as accurate as it is possible to be.

HMRC are satisfied that a debt is due and payable

Responses to the initial consultation raised the issue of the importance of ensuring that the right taxpayers were identified, that they were aware of the debt (so that a taxpayer could not find amounts in their accounts frozen because HMRC had not been able to contact them) and that, in parallel, vulnerable taxpayers were adequately supported.

These points were accepted by the Government, and in the summary of responses to that consultation, it guaranteed that "every debtor will receive a face-to-face visit from HMRC's agents, before their debts are considered for recovery through DRD". This face-to-face visit was intended to verify the taxpayer's identity, identify vulnerable taxpayers, and discuss options for payment, with "only debtors who have received this face-to-face visit, have not been identified as vulnerable, have sufficient money in the bank and have still refused to settle their debts" being considered for debt recovery through DRD.

The commitment to face-to-face visits can still be found in the Explanatory Memorandum to the Finance Bill: however, despite representations on this point, the DRD legislation itself only requires HMRC to be "satisfied that the person is aware that the sum is due and payable". It is disappointing that the Government's full commitment has not been incorporated into the legislation: whilst guidance can play an important supporting role, we believe that such important safeguards should have been given legislative status.

Other safeguards

The Government has committed to other safeguards to ensure that the DRD legislation works (and is used) as intended. These include:

- A commitment that a taxpayer will be left with at least £5,000 across all their accounts after a debt has been held.

- Specific resource and training being allocated to help ensure that vulnerable taxpayers are identified.

- A 30 day period between a taxpayer being notified that amounts in their account(s) have been held and those amounts being paid over to HMRC, during which they can raise an objection. Grounds for objection include that the Hold notice will cause "exceptional hardship" even after the £5,000 is taken into account, and any others with an interest in an account (including a joint account holder) can also raise an objection.

- A right of appeal to the County Court where a taxpayer (or another person with an interest in the account) does not agree with HMRC's decision on any such objection;

- Provision of a dedicated phone line for those subject to DRD to use to contact HMRC; and

- A full HMRC review of DRD, to be carried out after two years.

The £5,000 minimum amount and the rights of objection and appeal are included in the legislation, which is welcome. However, as amounts will remain subject to a Hold notice whilst objections and appeals are carried out, taxpayers may still be unable to use their funds for an extended period. It will be vital, therefore, that objections and appeals are considered promptly. The HMRC guidance – particularly around what may or may not fall to be treated as "exceptional hardship" – will also be important.

The mechanics of DRD

DRD is operated by the issue of notices by HMRC to banks and other deposit takers. The first type of notice (an Information notice) requires a bank to provide HMRC with certain information to enable HMRC to decide whether a Hold notice should be issued. A Hold notice requires the bank to, essentially, freeze the specified sum and notify HMRC that this has been done, and a Deduction notice requires payment of that sum to HMRC. Draft secondary legislation, setting out the information that banks need to provide when issued with Information or Hold notices, was published for consultation alongside the main legislation.

The legislation imposes specific time limits within which banks must provide the information or take the action required. Failure to meet these deadlines can result in penalties, as can 'tipping off' an account holder that an Information or Hold notice has been received prior to amounts in the relevant accounts actually being held. It is inevitable that these requirements will bring an additional compliance burden for banks.

The timescales themselves may mean that a taxpayer does not receive notification that amounts are held until some time after they have actually been frozen. A bank must notify HMRC within five days of putting a Hold notice into effect, and HMRC themselves are only obliged to inform the taxpayer "as soon as reasonably practicable". Although the 30 day objection period only starts to run when HMRC issue the notice informing the taxpayer, this does not alter the fact that amounts may be unavailable for longer.

Summary

Whilst we support the underlying objective of ensuring that taxpayers cannot choose not to pay tax that is due, the legislation as drafted does give rise to some concerns about the potential impact on compliant taxpayers, vulnerable taxpayers or those who require support to get past what the Office of Tax Simplification recently referred to as the "brown envelope barrier" in their dealings with HMRC.

We believe that all the key safeguards (and notably the promised face-to-face meetings) should have been included in the primary legislation: as this has not happened it is important that they are set out robustly in the HMRC guidance and that HMRC then follow that guidance consistently. Above all, it is important that the use of DRD is properly targeted against accurately assessed debts, and those taxpayers who (in the words of the original consultation) "are able to pay what they owe but have chosen not to do so".

The commitment to a review of DRD after two years is particularly welcome: whilst we believe that a post-implementation review of all substantial legislation would be beneficial, it is particularly important in cases such as this where HMRC are given such substantial new powers.

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