Dealing with tax debt

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Chris Holmes and *Jennifer Jones* examine HMRC's approach to tax debt, and the best approach for taxpayers in difficulty

Key Points

What is the issue?

This article looks at the overriding principles when dealing with HMRC's Debt Management and Banking Unit and offers some practical tips for agreement of a Time to Pay Arrangement (TTPA) with HMRC.

What does it mean for me?

If HMRC has no idea of the cause of debt, then the assumption is that a taxpayer is simply ignoring it and the full force of debt action follows.

What can I take away?

When faced with a tax debt that the taxpayer believes they can settle over a period of time, the best option is to negotiate a TTPA with HMRC, which may incorporate funding from future income streams.

In response to the Covid-19 health pandemic, the UK government announced extra resources to assist those struggling to pay their tax liabilities due to financial distress. In March 2020, HMRC started suspending debt collection proceedings where Covid-19 is the reason for problems paying tax bills. In the early weeks of the Covid-19 lockdown, our experience showed that payment deferrals were agreed with HMRC following a relatively brief phone conversation.

However, from the start of May 2020, HMRC indicates that it will now take a tougher approach if taxpayers need Time to Pay Arrangements (TTPAs). HMRC is reverting back to its pre-Covid-19 position of expecting an informed conversation with evidence when TTPAs are requested. This article looks at the overriding principles when dealing with HMRC's Debt Management and Banking (DMB) Unit and offers some practical tips for agreement of a TTPA with HMRC.

Overriding principles for dealing with HMRC's Debt Management and Banking unit

Tax debt is unlike any other type of debt. The worst thing a taxpayer can do is ignore tax debt. Tax debt never goes out of time, as there is no statute bar. There are statutory deadlines for tax assessment, but not for the collection of tax. DMB officers want to see action being taken to address a tax debt. For them, silence or ˜head in the sand' is the worst situation.

If HMRC has no idea of the cause, then the assumption is that a taxpayer is simply ignoring them and the full force of debt action follows:

1. DMB follows a debt collection process which escalates over time. Until the debt is paid or the file closed, the best that a taxpayer can expect is that the process is temporarily paused. DMB expects that everything is being done to deal with the debt in a timely manner.
2. It is important that a taxpayer, or their adviser, talks regularly with DMB until payment terms are agreed. There is a dedicated agent helpline for debt management. You should consider DMB as a separatearm of HMRC from its inspectors. If you are working with the inspectors to close a tax enquiry, you should nevertheless keep DMB informed, or they may continue the debt collection process.
3. The speed with which DMB accelerates its collection process will vary on the nature of the tax being assessed. Ingeneral, where the taxpayer collects the tax from other people, e.g. PAYE and VAT, HMRC is far less sympathetic with its collection; it was never the taxpayer's money to spend elsewhere.
4. DMB can swiftly locate taxpayers (even those who do not give their latest address to HMRC!), due to its use of credit agencies. The first that a taxpayer knows about a tax debt can be when a DMB bailiff is on their doorstep.
5. DMB follows a strict policy set downfor it by government. When looking at an individual case, its decisions can look uncommercial. However, the policy is to look at the general population and the total tax take “ the knock-on impact of agreeing one case could lead to an overall fall in tax collection if DMB is known to ˜do deals'.

The DMB's objective is twofold: to collect the tax; and to ensure that future tax is paid on a timely basis.

Is the tax debt correct and enforceable?

When presented with a tax bill, the first thing to do is to assess whether the debt is correct and enforceable.

To be enforceable, there must be a formal assessment. However, not everything is a formal assessment, and HMRC may need to do something to create a legally enforceable debt.

For example, for an individual with a small PAYE underpayment, HMRC may issue a form P800. This is essentially no more than a calculation of the tax underpaid, and a request for settlement will follow, either through adjusting the tax code for subsequent years, or by direct payment.

If the P800 liability remains unpaid, HMRC will need to formalise the liability, either by issuing a Simple Assessment or by issuing a notice to the taxpayer to complete a tax return. If the tax return is not then completed to self-assess the tax, HMRC can raise a determination notice.

HMRC's attitude to informal assessments is much more flexible, as they are not bound by legal process. It has greater capacity and willingness to ˜forgive' a debt under its Powers and Management before a formal process commences. Hence, it is always better to speak to HMRC before a formal assessment process is issued.

Depending on the nature of the debt, you may be able to take formal action to reduce the liability:

- **Determinations:** Where tax is estimated through a determination, it may be possible to appeal the assessment by preparing and submitting a tax return, resulting in the estimated tax liability being replaced by an actual liability. However, for income tax and corporation tax, HMRC is unable to accept such returns if the year is closed (or if the determination was issued prior to the last 12 months. If it is too late, the sole option available is to seek Special Relief, but this is only available in exceptional circumstances and where it can be demonstrated that it would be unconscionable for HMRC to collect the tax. See SA Claims Manual SACM12220 onwards.
- **Errors:** If the tax liability arose from an error on a tax return, the taxpayer may be in time to amend the return or to claim overpayment relief “ both of which have strict deadlines for claims.
- **Postponement:** If certain assessments are appealed, the tax remains enforceable unless it is formally postponed.
- **Claims and elections:** The taxpayer may be able to make claims or elections that could reduce the tax liability; for example, loss relief claims.
- **Reduce payments on account:** Where the amount sought by the DMB includes an individual's payments on account for the current year, it may be possible to reduce them. Use Form SA303 or the online Personal Tax Account.

- **Appeals:** HMRC, and the tribunals, may also consider late appeals where taxpayers have a ˜reasonable excuse'. Similarly, if the debt includes penalties, there may be an opportunity to appeal these.

Options for settling the tax debt

Once it is confirmed that the tax debt is correct and enforceable, the taxpayer must determine how it can be paid. If a taxpayer cannot pay the tax debt immediately, they will most likely need to consider their ability to pay the debt from their future income. The taxpayer may also have other options for funding payments to DMB to settle the debt, including:

- **Sale of an asset:** If the taxpayer needs to sell an asset in order to raise funds to pay the tax, DMB is usually willing to pause collection proceedings, providing it can see a real attempt is being made to sell the asset. If proceeds from the sale will only partially repay the debt, DMB will look to collect the balance due prior to disposal.
- **Anticipated cash inflow:** Sometimes a taxpayer expects to receive a large sum of money at some time in the future from which they can pay the tax; for example, payment by a debtor or an inheritance. Although such promises give DMB an element of comfort, they carry inherent uncertainty. DMB may want documentary evidence to formally take them into account when considering repayment terms.
- **Charge on home:** In exceptional circumstances, a taxpayer may consider granting HMRC a secondary charge on their home as security. Such action must be considered very carefully and should only be done in conjunction with agreeing an achievable TTPA as a failure to pay any agreed instalments could lead to the loss of the home, without the need for HMRC to formally make the taxpayer bankrupt. It is also wise to seek legal advice.
- **Anticipated tax refund:** Clearly, this is an area where HMRC will have more certainty and greater control over the funds. It is therefore more likely to consider the use of anticipated tax refunds as part of the settlement process.
- **Third party finance:** The taxpayer could try to borrow funds commercially or personally to fund repayment of the debt, or to fill a temporary funding shortage.
- **Remission:** In very exceptional circumstances, HMRC may agree not to pursue the debt. Remission can apply where payment of the tax would cause a person

severe hardship, they have no assets that could be sold to pay the tax, and their circumstances are such that they are unlikely ever to be in a position to pay the tax “ usually due to severe illness or age. The tax debt is not formally written off, but collection proceedings are permanently put on hold. If the taxpayer's circumstances change, and they become able to pay the tax debt, it will be collected; for example, if they receive an inheritance. Generally, remission needs to be requested by the taxpayer.

Arguably, when faced with a tax debt that the taxpayer believes they can settle over a period of time, the best option is to negotiate a TTPA with HMRC. This may incorporate funding from future income streams, together with the other options noted above.

Time to Pay Arrangements

A TTPA may be negotiated with DMB to enable a taxpayer to defer payment of any taxes and duties, settling them by agreed instalments over a number of months. The benefits of obtaining a TTPA include the following:

- Certainty can be obtained over this aspect of a taxpayer's cash flow. The TTPA may also be entered into as part of an overall exercise to restructure a company's finance to enable it to continue trading or meet banking covenants.
- Paying taxes late often results in penalties but these may be avoided provided the TTP application is submitted before the due date and the payments are made under the TTPA terms.
- Entering into a dialogue leading to a TTPA means that HMRC is unlikely to use its debt collection power, such as direct recovery from bank accounts.
- Upon agreement of a TTPA, DMB will put further enforcement action on hold pending full settlement of the amount due. This can prevent an adverse impact on credit ratings.

The maximum period over which DMB will agree TTPAs depends largely on the quantum and nature of the debt, together with where the debt is in the collection process. For example, with Self-Assessment DMB will rarely agree a TTPA longer than two years, but for VAT and PAYE it is unlikely to be beyond 12 months. If the debt is in the latter stages of the process, DMB may only agree a TTPA covering a few months.

It is worth noting that as a result of the loan charge review, we have seen a general shift towards longer TTPAs, including five years minimum for those who met the criteria, and seven years minimum for the lowest earners.

It is therefore important that the taxpayer makes their ˜best offer' to DMB within the parameters of what they can afford to avoid a hard rejection and escalation of debt within the enforcement process. When preparing the TTPA proposal to DMB, the following should be considered:

- For individuals, average monthly income/expenses will help to determine affordability. Future income projections are important, incorporating anticipated one-off income/capital receipts such as inheritance or proceeds from asset disposals. DMB may ask for details of an individual's monthly income and expense statement, in addition to a personal statement of assets and liabilities.
- For corporates, DMB may request cash flow forecasts to support any TTPA proposal, together with the latest management accounts and company cash reserves. DMB may also want taxpayers to demonstrate that they are taking steps to manage their costs (e.g. directors reducing their salaries).
- Whether the taxpayer has any assets that can be sold to realise funds to pay the tax debt.
- Whether any third-party financing can be sought to realise funds. This may include bank loans, cash injections from shareholders, and loans from friends or family.
- Repayment of other debts during the period covered by any TTPA.
- Payment of future tax liabilities when they fall due “ HMRC expects future tax liabilities to be paid on a timely basis. The proposal should therefore include provision to put aside monies to pay future taxes.

Offering an upfront payment as part of the TTPA offer increases the chance the offer will be accepted.

If the taxpayer has the ability to make a part payment, it is generally better to include it in the TTPA offer than to first make the payment and then seek to agree a TTPA with HMRC for the balance. It is important that the taxpayer makes payments under the TTPA as they fall due and talks to HMRC if an instalment will be late or a direct debit is cancelled. If payments are repeatedly late or missed, HMRC will withdraw from the agreement and resume collection proceedings. Any late payment penalties or surcharges stood over will also come into charge.

HMRC will not always agree a TTPA. This may be because the period sought by the taxpayer to repay the debt is too long, a payment holiday is required or because the taxpayer previously had a TTPA for either the same or a different tax debt.

In the event that a formal TTPA cannot be agreed with DMB, the taxpayer may wish to make payments towards the tax debt on a voluntary basis, for an affordable amount. By doing this and thereby reducing the tax debt, hopefully repayment terms can be offered later in the collection process that meet DMB's requirements. As is generally the case when dealing with HMRC, a proactive approach is recommended to deal with debts prior to payment deadlines. Keep documentary evidence and records of action being taken to support payment, borrowings and fundraising. We must help taxpayers avoid the ˜head in the sand' approach wherever possible.

From our practical experience during the Covid-19 pandemic, we recognise that many taxpayers have turned to the tax charities for support. Please donate to Bridge the Gap if you are able to.

BDO's online portal for all government measures on providing financial support can be viewed here.

- We should very much appreciate your completing our survey about the impact of coronavirus on you and your organisation. We are gathering this information to help us continue to support and inform you. Please click here to complete the survey. The closing date is 30 June and we shall provide a report on our websites in July.