The City of London Law Society

4 College Hill
London EC4R 2RB
Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 - Cheapside 2
mail@citysolicitors.org.uk
www.citysolicitors.org.uk

Andrew Willis
HM Revenue & Customs
Debt Management and Banking
Room 3/46
100 Parliament Street
London
SW1A 2BQ

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Dear Sir

Revenue Law Committee response to Direct Recovery of Debts ("DRD")

The City of London Law Society ("CLLS") represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Revenue Law Committee.

Introduction

We are responding to the DRD Consultation Document issued on 6 May 2014. Whilst our primary focus is on the impact of the proposals on large businesses and deposit takers, we also raise a number of important issues related to the rule of law, separation of the powers and the impact of the proposals on stakeholders whom we do not represent, including the more vulnerable members of society.

We regard these proposals as both radical and controversial and not merely an "administrative measure" as referred to in paragraph 2.11 of the Consultation Document. This is a clear case where the consultation should have commenced at Stage 1 of the Tax Consultation Framework, not Stage 2. Accordingly, we do not propose to answer

the specific questions on the fine detail of the proposed DRD scheme but instead focus on why as a matter of policy we believe the proposals are seriously misguided.

We support HMRC's initiatives in tackling those who deliberately do not pay their tax liabilities. In principle, some of our members might support a very limited form of DRD if it could be guaranteed to operate not to impact on innocent taxpayers, but under the current proposals that is unlikely.

Objections

We have two fundamental objections to the proposals:

- the fact that it will be HMRC and not the Judiciary making decisions on the application of DRD; and

- the real potential for mistakes to be made by HMRC and the adverse consequences that will have for taxpayers.

The Consultation Document proceeds on the basis that DRD will be introduced and describes how HMRC will operate it (and at some points, for example paragraph 3.4, seems to be written on the assumption that DRD is already in place). Whilst we completely reject the introduction of DRD, what is lacking in the Consultation Document is any indication of what the proposed legislation will say and how much of the application of DRD will be legislated for (as opposed to being in HMRC guidance only). We would regard this as an area where it would be totally inappropriate for widely drafted legislation supplemented by HMRC written guidance or practice. The detail should be set out in primary legislation which has been subject to scrutiny by Parliament, preferably in a Finance Bill Committee of the Whole House.

As a constitutional issue to protect the rights of taxpayers we believe it is fundamentally wrong that HMRC will have the sole power to impose DRD and to make judgements on issues such as whether a particular taxpayer can pay but will not pay or genuinely cannot pay (paragraph 2.5). We are very concerned that it will be HMRC who will exercise judgement on "the safeguards" including the decision on whether hardship will be caused. Significant powers are proposed for HMRC as indicated; for example, by the statements in paragraphs 3.10, 3.11, 3.15, 3.16, 3.22, 3.25, 4.1 and the penultimate bullet in case study 1 (continued) on page 12. We are also concerned that DRD is to apply to estimated assessments.

The decision on whether to issue a DRD notice should be made by the Judiciary, as is the case for third party notices in civil cases. If there are problems with the current Judicial system then this should be reviewed to make it more streamlined and cheaper where necessary. We note that although HMRC regard the current Judicial process as unsatisfactory the Consultation Document proposal shifts the Court process on to the taxpayer. We regard this as unacceptable – see below.

We regard the analogy with child maintenance debt as completely inappropriate as with the DRD proposals it is a branch of the executive dealing with debt owed to it, rather than acting as an intermediary between two members of society; HMRC could never be independent when operating DRD.

Observations on the "safeguards"

We note that it is proposed that a taxpayer can seek Judicial Review where there is an objection to a DRD notice. We regard the possibility of a taxpayer seeking a remedy

after HMRC has recovered the debt as an unacceptable shift in the balance of power between the executive and taxpayer and one that is wholly disproportionate to the expected gains (we question too whether there would be any meaningful gain from DRD as sophisticated tax evaders will be aware of the DRD process and would likely be able to move their money before the DRD process is commenced). Not only is the shift in power unacceptable – placing the burden on the taxpayer to recover the sums taken – the proposed remedy of Judicial Review is a restrictive remedy subject to short time limits and the cost is likely to be outside the means of a taxpayer who has wrongly been subject to DRD (and disproportionate to the tax outstanding). Putting the burden and cost of Judicial Review on a taxpayer, particularly the more vulnerable members of society, in relation to what are likely to be small tax debts cannot be regarded as a real safeguard.

Whilst we note that HMRC intend to have "safeguards" to ensure that DRD is not used inappropriately, we regard it as impossible for an organisation of the size and complexity of HMRC (whose processes are largely automated) not to make mistakes. The consequences of mistakes with DRD would be of a different magnitude to mistakes made in, for example, assessments due to the fact that payment is taken and there is only a limited remedy which, in practice, most taxpayers will struggle to use.

Regarding HMRC contacting taxpayers up to nine times, it may be impossible to distinguish cases of a taxpayer deliberately failing to reply from cases where HMRC had the wrong information. HMRC errors are inevitable. Here we note, for example: recent press reports that almost half the fines issued by HMRC for the late filing of VAT returns were incorrect (*Telegraph* 19 May 2014); HMRC acknowledging that it had massively overpaid Tax Credits; and a very recent press report that the number of errors in the HMRC system is on the rise, with up to 3.5 million employees having to pay money back (*Telegraph* 20 June 2014). It is also of deep concern that the proposed powers are to apply to estimated tax assessments where there is the possibility of further mistakes in calculations made. In our view, if HMRC cannot demonstrate that its own systems are completely fit for purpose DRD should not be introduced. Weighing up the potential for mistakes against the likely tax take we regard the proposals as an HMRC power that is disproportionate to the expected gains.

We also regard the proposals with regard to joint accounts as too crude and potentially vulnerable to challenge under the Human Rights Act 1998.

Whilst we oppose any form of DRD, if Parliament were to introduce rules we believe the power to issue a notice should be limited to senior figures in HMRC (like the GAAR) and that this should be set out in legislation.

We also question not only the power given to HMRC to make judgement on the safeguards (due to lack of independence) but the proposed safeguards themselves. Analysing a person's bank accounts for the previous 12 months to ensure no undue hardship is caused is inadequate. In the context of business accounts it will be impossible for HMRC to know what business expenses are required to be paid in a future period, for example there may be a bullet repayment of an outstanding loan or capital expenditure earmarked for investment in plant and machinery.

As a point of detail, the problems with the safeguards described above are exacerbated by the very short (14 day) time period afforded to taxpayers to pay, object or show hardship once the relevant bank has been instructed to put funds on hold. This could result in significant prejudice and does not distinguish between taxpayers who are unable to pay and those who do not intend to pay.

Other points

We are also concerned that the proposals effectively reintroduce Crown Preference, which is contrary to Government policy and may require changes to insolvency law. We doubt that this is intended but again this highlights another difficulty with these proposals. We would also like to see more detail on the proposals for rectifying mistakes and paying compensation. We are concerned that HMRC may not have the necessary incentive to rectify mistakes. We would like to see a statutory procedure for rectifying mistakes and paying compensation.

Further, we would want to understand what powers HMRC would use to collect information regarding taxpayers' bank accounts. Would those powers be used against the taxpayer or against the bank? Would there be statutory provisions to ensure that deposit-takers who comply with a DRD notice which was later proved to be erroneous or subject to successful legal challenge have statutory protection from third party claims and/or a statutory right to compensation from HMRC?

We were also concerned to see that the Consultation Document refers to similar powers in the US being used "routinely". We are therefore concerned that if HMRC were given wide DRD powers they may be exercised in far more cases than the Consultation Document implies.

Conclusion

In conclusion, we think the proposals are deeply flawed and they also represent a dangerous precedent regarding the balance of power between HMRC and taxpayers. Further, we are not convinced that such fundamental and draconian proposals will achieve their intended goal. We believe the proposals should be dropped completely. If that is not possible we believe the consultation should restart at Stage 1 – considering the policy of the proposals opening that policy up to a wider public debate.

Yours faithfully,

Simon Yates
Chair
The City of London Law Society Revenue Law Committee

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

Individuals and firms represented on this committee are as follows.

S. Yates (Travers Smith LLP) (Chairman)

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B. Coleman (Ropes & Gray International LLP)

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