HM Revenue
& Customs

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

Summary of Responses
February 2014

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1. Introduction

1.1 At Budget 2013, the Government announced its intention to publish a consultation on the proposed legislative changes to the collection of debt using the tax code.

1.2 The consultation document 'How to improve HMRC's collection of debt: coding out' was published on 11 July 2013, with all responses asked for by 5 September 2013.

1.3 The consultation document explained how HMRC currently uses the PAYE system to collect debts, underpayments and SA balancing payments (known as coding out), and how this system had been developed and improved. It then explained the changes that were proposed.

1.4 The proposal was that HMRC would improve its collection of debts, underpayments and SA balancing payments through coding out, by making the process fairer. This included increasing the maximum amount that could be recovered through coding out from those with higher incomes.

1.5 Following the consultation, **the Government now plans to proceed with the debt collection elements of the proposed changes, and the extension of the 50 per cent overriding coding out limit[1] to all tax codes.** The provisional timetable for this is to consult on draft legislation later this year. Under current plans, the first use of the new codes would see deductions made via coding out from April 2015.

1.6 Following further analysis of the potential benefits, the Government has decided not to introduce a graduated and increased limit for coding out PAYE underpayments and SA balancing payments.

The responses

1.7 A total of 23 responses were received, of which three came from private individuals. HMRC is very grateful to everyone who took the time to respond to the consultation.

1.8 In general, the responses supported the proposals' intentions, recognising that coding out as a mechanism for debt collection is convenient for both taxpayers and HMRC.

1.9 Chapter 3 summarises the responses in more detail, and gives the Government's response to them.

[1] See 2.13

2. Current approach to coding out and the improvements proposed

Current approach to coding out

2.1 The following section details how HMRC currently uses coding out to recover debts.

Coding out debts

2.2 Coding out is currently used to recover Tax Credit and Income Tax Self Assessment debts, where they have not been paid voluntarily, as well as penalties. HMRC will start collecting Class 2 NIC debts in this way from April 2014. It is now an established and routinely applied method of collecting debts of under £3,000.

2.3 To collect in this way, HMRC assigns a new tax code to the taxpayer, increasing the deductions made from their earnings by their employer. By deducting the money from their pay, the repayments are made without the individual and HMRC needing to take further action.

2.4 HMRC always sends a letter to the taxpayer explaining the intention to code out. The amount of debt to be collected through the PAYE code is then shown on the Annual Coding Notice (P2) which is sent to the taxpayer before the new tax year starts on 6 April. HMRC offers help to any taxpayer who believes that having a debt collected by reducing their tax code will cause financial difficulty. Anyone who has concerns about the debt being collected through the code is advised to contact HMRC immediately.

Coding out underpayments

2.5 Coding out can also be used where there has been an underpayment via PAYE or an SA balancing payment (an amount owing under a taxpayer's SA tax return) is due, providing it is below the £3,000 limit.

2.6 For SA balancing payments, taxpayers have to ask on the SA return for the money owed to be coded out. A taxpayer can contact HMRC if they do not want to have their PAYE underpayment coded out. They will then need to submit a SA return and pay the outstanding amount by the 31st January after the end of the tax year.

Proposed changes to coding out

2.7 The consultation document proposed to introduce a graduated limit for

the coding out of debt, PAYE underpayments and SA balancing payments. The consultation document stated that more work was planned on establishing the extent of the benefits of introducing these new limits for PAYE underpayments and SA balancing payments. Following this work, the Government has decided to keep these coding out limits at the current level of £3,000 per annum. The changes to the maximum amount of debt that can be coded out will go ahead in line with the original proposals.

2.8 However, the proposal to extend the 50 per cent overriding limit[2] will still apply to PAYE underpayments and SA balancing payments, as well as to debt. This proposal was very popular with respondents, and ensures that the updated proposals for improving coding out continue to offer taxpayers proper protection from hardship.

Proposed changes to the annual limit

2.9 The Government's aim is for HMRC to make more use of coding out, collect more from higher earners while protecting lower earners and extend the focus of coding out to include collection of larger debts.

2.10 The Government therefore proposes to replace the current single scale for the coding out of debts with a graduated scale of limits. This would:

- Protect those on lower incomes, with no change to the maximum that could be coded out for those earning less than £30,000;
- Introduce a graduated, income-related scale for those earning £30,000 or more so that a maximum of £17,000 could be coded out for a person with earnings over £90,000.

2.11 The graduated limit would apply for those with a primary source of annual PAYE income of £30,000 and over. The proposed graduated scale is shown below.

PAYE Earnings[3]	<£30k	£30k -£40k	£40k - £50k	£50k - £60k	£60k - £70k	£70k - £80k	£80k - £90k	>£90k
Coding Out Limit	£3k	£5k	£7k	£9k	£11k	£13k	£15k	£17k

2.12 The new limits would only apply to the collection of debt, and not to PAYE underpayments or SA balancing payments. The current limit of £3,000 for PAYE underpayments or SA balancing payments will continue.

[2] See 2.13
[3] Gross yearly income figure

50 per cent limit on PAYE deductions

2.13 A K-code is a tax code used in circumstances where the deductions in a tax code are in excess of the individual's personal allowances[4]. PAYE legislation currently provides an overriding limit of 50 per cent for K-codes. This means that when an employer operates a K-code it will not result in deductions of more than 50 per cent of the employee's relevant pay. Other tax codes do not have similar statutory safeguards although HMRC's business rules have built similar limits into the IT systems that seek to protect customers from excessive deductions.

2.14 To ensure a consistent approach, the Government now proposes to extend the legislative 50 per cent overriding limit to all tax codes, so that employers and pension providers do not make deductions in excess of 50 per cent of an individual's relevant pay.

2.15 This limit would apply to the collection of debts, SA balancing payments and PAYE underpayments, as proposed in the consultation document.

Partial collection through coding out

2.16 HMRC has the power to split debts so that part of a debt is collected through the tax code up to the coding out limit, with the remainder collected through another collection method. The consultation document proposed to explore the potential to make best use of this existing legislation. HMRC plans to proceed with this, subject to further cost analysis.

[4] Personal allowance for 2013/14 is £9,205.

3. Comments and Response

3.1 A total of 23 responses were received, of which three came from private individuals.

3.2 In general, the responses supported the proposals' intentions, recognising that coding out as a mechanism for collecting debts, PAYE underpayments and SA balancing payments was convenient for both taxpayers and HMRC.

3.3 Many responses also asked questions about coding out in general. Although not directly relevant to the consultation, HMRC thinks it would be useful to take the opportunity to respond to some of these here.

3.4 The consultation asked five questions, and then invited wider comments. This chapter describes the answers given to these questions and then discusses the other comments received. A response to these issues is also included.

Response to the consultation's 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?

3.5 Although several responses did suggest changes to the proposed coding out limits, it was generally felt that they were set at the right level. In particular, responses praised the proposals to make coding out more widely available to taxpayers. The quote below was fairly typical of comments, which recognised the importance of graduated limits working in tandem with the 50 per cent overriding limit:

> **"Coupled with the proposal to extend the 50 per cent overriding limit for PAYE deductions to all tax codes, which is to be welcomed, this does appear to us to be a sensible approach to collecting debt."**

3.6 Those responses that did raise concerns about the graduated limits generally focused on the proposed £17,000 limit on those earning more than £90,000. They argued that such a limit could cause hardship for high earners.

3.7 The Government consider that the built-in safeguards in the PAYE system provide protection from hardship for all taxpayers. The

proposed extension of the 50 per cent limit to all tax codes will ensure that no more than 50 per cent is deducted from an employee's relevant pay. All taxpayers who have difficulty in paying will be advised to contact HMRC immediately to discuss alternative payment options.

3.8 There was a lot of interest in how the Government had decided upon the proposed limits. The Government considered a number of options and decided that the limits proposed strike a good balance between simplicity to operate and fairness to the taxpayer. They allow HMRC to make more use of this cost-effective recovery method to reduce higher value debts, while still protecting lowers earners.

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?

3.9 The respondents answer to this question was, broadly speaking, yes. Responses generally felt that the proposals did provide adequate support for low earners.

3.10 Several responses did take the opportunity to suggest other measures that could be taken to further protect low earners. Others took the opportunity to remind HMRC of the need for protection of lower earners to be thorough and compassionate, a need which HMRC fully accepts and has reflected in the proposals.

3.11 HMRC would note here that it is important to emphasise that the coding out limits are only one aspect of HMRC's work to protect taxpayers from debt or underpayment-related hardships. As discussed in more detail below, the PAYE system has built-in safeguards to prevent hardship by ensuring that no more than 50 per cent of relevant pay is deducted. There is also an established policy of encouraging any customer who has difficulty in paying to contact HMRC immediately to discuss alternative payment options. Contact details for this are on HMRC letters and sign-posted on the website.

3.12 HMRC is confident this will provide suitable protection for taxpayers, regardless of income and other debts they may have.

3.13 One respondent suggested that the coding out limit should be tied to the Consumer Price Index (CPI), to ensure it protects those it is intended to safeguard. Parliament does have the ability, if necessary, to adjust the limits using secondary legislation. The Government believes that it is preferable to continue to make changes using that power rather than via an automatic change in line with CPI, which would see changes made to the limits every year, and therefore introduce an element of uncertainty for the taxpayer and an increase to the administrative burden on the system. The Government also believes that these new limits will be suitable for the foreseeable future

without the need for year-on-year increases.

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

3.14 Responses widely supported the proposal to extend the 50 per cent limit on what can be taken from an individual's relevant pay via PAYE, so that it applies to all tax codes. Currently the legislation that provides this overriding limit only applies to K-codes. The proposed extension to cover all codes in legislation was welcomed as an important safeguard to protect taxpayers from hardship. The two quotes that follow were typical of the comments made:

> **"[We support] the proposal setting the 50 per cent regulatory limit across all tax computations. We see it as being simple to manage. It would also be helpful to employers, payroll professionals and agents, and will also protect wage earners."**

> **"Extending the statutory safeguard to include all codes would be a welcome safeguard."**

3.15 However clarification was sought on a few points. The first was how this measure would interact with higher-rate taxpayers. HMRC can clarify that the limit will apply to all taxpayers, regardless of their income or original PAYE contributions. When determining how much can be collected using coding out, all aspects of an individual's income are considered. The capacity to code out is always calculated considering the 50 per cent limit and if the amount of debt suggested for coding out would exceed this deduction limit then a reduced amount, which would not exceed this limit, would be included in the tax code instead.

3.16 Another response suggested that taxpayers should have the option to have more than 50 per cent of one source of income coded out. HMRC has no plans to redesign coding out to allow for deductions in excess of 50 per cent, since the limit is a crucial aspect of HMRC's work to prevent any hardship being caused by coding out. However, where customers are primarily motivated by speedy payment, HMRC would encourage them to pay the full amount owed immediately, rather than using coding out at all.

3.17 Beyond these points of clarification, this extension of the 50 per cent limit was strongly welcomed. It is partly for this reason that, despite the decision to not extend the graduated limit to balancing payments and PAYE underpayments, the 50 per cent limit will, as proposed, apply to all coded out debts, underpayments and SA balancing payments.

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?

> **"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."**

3.18 This question attracted a large number of responses. Most were very supportive of this proposal, praising it for increasing the options available to taxpayers and generally making it easier for taxpayers to cope with large debts and underpayments.

3.19 A few responses raised concerns about how this would be communicated to customers, noting the potential for confusion.

3.20 HMRC agrees that effective communication is crucial to the success of coding out, in particular now that different limits will apply to the coding out of debt, PAYE underpayments and SA balancing payments. Taking this into account, HMRC is committed to helping those affected adjust to the proposed changes by ensuring that appropriate additional guidance is published well in advance of the changes coming into force.

3.21 The consultation document also announced that HMRC is considering using existing legislation to code out debts over multiple years. This attracted a similar response (some very positive, others raising concerns about how it would be applied and, particularly, the risk of multiple years' debts accruing). HMRC is keeping this proposal under consideration, but is not proposing to introduce it alongside the rest of the changes consulted on.

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

3.22 This question received the fewest responses of the five. Some respondents asked for clarification about the economic impact and the cost figures. A revised table of impacts will be published alongside the secondary legislation in due course.

Other comments and questions

3.23 Other comments on the proposals and on coding out in general, tended to fall under the following categories.

Communication

3.24 A large number of responses asked how HMRC planned to explain coding out to customers. They suggested that some customers struggle to understand tax codes and that these proposals could compound this issue. HMRC accepts this point and is therefore committed to helping those affected to adjust to the proposed changes by ensuring that appropriate additional guidance is published well in advance of the changes coming into force.

3.25 It is also worth noting that there is established guidance in place to help taxpayers and their advisers understand coding out. This guidance is kept under review. In addition, the Employers Helpline is in place to advise employers, while the Taxes Helpline is in place to advise employees. HMRC advises employers to direct the employees back to HMRC when they have questions about their tax code. This escalation route is already well established in the current coding out system.

Agreement before coding out begins

3.26 A large number of responses asked what agreement would need to be reached between HMRC and the taxpayer before coding out of debts would begin. HMRC is not proposing to change its policy on this. As now, if customers do not want their debt recovered through their PAYE code, they should contact HMRC to discuss an alternative payment method. The established process for notifying taxpayers of coding out is described in 2.4.

Customers with more than one source of income

3.27 Some responses argued that coding out appears to favour customers with more than one source of income, because the coding out limit is only based on their primary PAYE source, rather than total income.

3.28 It is true that those with multiple sources of income will only be eligible for coding out up to a limit based on their primary PAYE source. The Government did consider including all sources of income, but it was found to be too complex and expensive to implement. The current approach to coding out was designed to strike a balance between simplicity to operate and fairness to the taxpayer. The Government remains confident that it achieves this. The important point is that

customers will still have to repay the money they owe, regardless of whether it is coded out.

Effect of mid-year income changes

3.29 Some responses asked how mid-year changes to a taxpayer's income would affect the amount that HMRC would collect via coding out.

3.30 HMRC is not proposing to change its policy on this, and the current process will still apply:

- In the event of a taxpayer's income increasing, the deductions will continue as determined before the change in income.
- In the event of a taxpayer's income decreasing, the debt will still be coded out provided it does not trigger the 50 per cent limit on deductions from relevant pay. If the limit is triggered, the excess amount will no longer be coded out and an alternative method of payment will be arranged.

Other comments and questions

3.31 One response asked what impact these proposals would have on employees who are only in the UK on a temporary basis. HMRC's position here is that, with one exception[5], PAYE applies to all employees paid by a UK-based employer. If they are not working in the UK then their debt cannot be collected through coding out. There is nothing in these proposals that will change this.

3.32 One response asked what the impact of these proposals would be on HMRC's use of debt collection agencies. Although those debts which are fully coded out will not require the use of debt collection agencies, such agencies will still form part of HMRC's wide range of debt recovery mechanisms.

3.33 One response asked whether the 50 per cent limit would affect a taxpayer's student loan repayments. Student loan deductions are calculated on the 'gross NIC able pay at the employment source', and so will remain at the same level regardless of the amount deducted under PAYE. HMRC's position is that this does mean that a taxpayer could have 50 per cent of their relevant pay coded out and still be expected to make student loan repayments. As explained above, taxpayers who have difficulty in repaying their debts are advised to contact HMRC immediately to discuss alternative payment options.

[5] PAYE82000 - PAYE operation: international employments: EP appendix 4: criteria for short term business visitors

4. Next steps

4.1. The draft secondary legislation, changing the maximum amount of debt that can be coded out and extending the 50 per cent overriding limit so that it applies to all tax codes, will be published for comment later this year.

4.2. Work has begun on the necessary changes to the SA and PAYE IT systems and processes, and it is HMRC's current intention to introduce these changes to apply from the 2015/16 tax year.

Annex A

List of those who made written responses or attended meetings

Written responses were received from

1. Insight Research & Analysis Ltd
2. ARM
3. BT Global Services
4. Chartered Accountants Ireland
5. Russell & Russell
6. Chartered Institute of Taxation (CIOT)
7. The Institute of Chartered Accountants in England and Wales (ICAEW)
8. TaxAid
9. The Association of Taxation Technicians (ATT)
10. Low Incomes Tax Reform Group (LITRG)
11. Elman Wall
12. The Chartered Institute of Payroll Professionals
13. Sage UK
14. Deloitte LLP
15. Tax Volunteers
16. The Institute of Chartered Accountants of Scotland (ICAS)
17. Association of Accounting Technicians (AAT)
18. Prudential
19. Payroll Alliance
20. IreeN

There were also three responses from private individuals.

Meetings were held involving representatives of

The Institute of Chartered Accountants of Scotland (ICAS)