



# **The Consequences of the Direct Recovery of Debts**

## **Legal Briefing**

*Written on behalf of the TaxPayers' Alliance by*

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## Summary

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New powers allowing Her Majesty's Revenue and Customs (HMRC) to seize funds directly from bank accounts – so-called 'Direct Recovery of Debt' powers – are flawed in both practice and principle.

The basic mechanism of the legislation allows HMRC to place "hold notices" – essentially, to freeze all but £5,000 of an individual's assets – if it "appears" that there is a debt to the Revenue. If there is no objection to the hold notice within the requisite period or an appeal has been dismissed, HMRC may then issue a "deduction notice" and oblige the bank to transfer the funds it requires.

However, this report shows that such powers would fly directly in the face of the principles of Magna Carta, property rights and due process.

Key findings include:

- Many of the "protections" in place for taxpayers are not as watertight as they might seem. In particular, HMRC promise face-to-face meetings with agents before money is recovered. However, this does not appear within the draft legislation, only appearing in the non-binding explanatory note to the draft clauses at the time of going to press
- It is possible to object to the issuing of a hold notice to HMRC and then to appeal to a court if HMRC overrule that objection. However, while an objection must be made within 30 days of the hold notice being served on the taxpayer, there is no minimum period within which HMRC must consider and determine the objection – all the while, the "hold notice" would still be in place unless collateral is provided
- The legislation allows for "Accelerated Payment Notices" (APN) which, as the current legislation is written, could again give rise to a situation in which a taxpayer wrongly issued with an APN could be subject to their account being frozen and money being seized without recourse to appeal
- "Hold notices," which freeze all assets above a minimum of £5,000, could leave individual taxpayers unable to meet their outgoings over a long period of time. It is hardly unknown for HMRC to make administrative errors, and if this occurs the lack of obligation on HMRC to answer appeals in a timely fashion could leave individuals struggling to pay the bills
- Companies are treated as individuals in British law, and as such an administrative error by HMRC leading to a hold notice could put a firm in serious danger of effective insolvency through no fault of its own

## About the Author

Francis Hoar, a member of Field Court Chambers in Gray's Inn, was Called to the Bar in 2001 and practises principally in the areas of public law, commercial law and employment.

Francis regularly writes and lectures on human rights, civil liberties and public law. He has written as an expert for legal journals and websites, including the *Modern Law Review*, the *Local Government Lawyer* and *Counsel*, and has contributed to a book on the reform of human rights law. He is an occasional contributor and advisor, as a legal expert, to *The Times*, *The Independent* and the Victoria

Derbyshire show on Radio 5 Live and has published a live seminar online, through the Local Government Lawyer, on 'Pursuing and Defending Claims under the Equality Act'.

Earlier this year, appearing against two Queen's Counsel, Francis secured a High Court judgment that voided the election of Lutfur Rahman as Mayor of Tower Hamlets and found him and his election agent guilty of corrupt and illegal practices. At seven weeks, this was the longest election petition in English legal history.

In May 2015, Francis was *The Times* [Lawyer of the Week](#).

## Introduction

This year marks the 800<sup>th</sup> anniversary of the sealing of the Magna Carta. The Charter's real significance was as a written recognition by the Crown that it was as much subject to the customary laws of the Realm as were its subjects; and as a foundation of the doctrine that the whole Realm (later understood to be the people) must consent to taxation, be free from arbitrary government and have unfettered access to the king's justice for the resolution of disputes.<sup>1</sup>

One of the provisions of the Charter, chapter 12, was that customary feudal taxation should not be imposed without the consent of the '*commune concilium*', the council of magnates that developed into Parliament later that century. While of limited effect in itself,<sup>2</sup> this provision was a critical stage in the evolution of a doctrine that was to become fundamental to the English (later British) constitutional settlement: that only Parliament – and, in particular, the House of Commons – could impose taxation.<sup>3</sup>

Magna Carta was also an early affirmation of the right of citizens to redress grievances through the courts: 'To no one will we sell, or deny, or delay justice or right.'<sup>4</sup> However limited the original meaning, it is the development and entrenchment of this right that matters. So far as property and taxation is concerned, the taxpayer must have the right to challenge any demand for taxation in the courts; and the Crown's actions must be as much subject to the judicial scrutiny as those of any person or company.

In May 2014, the government consulted on permitting HMRC to recover debt from taxpayers' bank accounts directly, without recourse to the courts and prior to any court judgment.<sup>5</sup> In December, it published draft legislation (the direct recovery of debts or 'DRD'<sup>6</sup>). This paper sets out the framework of the draft legislation, before outlining how it will deny taxpayers' their fundamental right to prompt access to the courts and the devastating consequences this may cause to individuals and businesses alike.

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<sup>1</sup> For a learned refutation of the idea of the Charter as a foundation of English freedom, see the speech of Lord Sumption, medieval historian and Supreme Court justice, to the Friends of the British Library of 9.3.2015:

<https://www.supremecourt.uk/docs/speech-150309.pdf>. Sumption allows, however, its symbolic importance.

<sup>2</sup> While this provision was also not confirmed by Henry III in 1225, the form in which the Charter became seen as a statute, the first true Parliament sat later that century: *Sumption, op cit*, p 11.

<sup>3</sup> See s 8 of the Petition of Right, 1627. The famous challenge to this doctrine was the decision in *R v Hampden, Ship Money Case* (1637) 3 State Tr 826, where a court held by majority that the King could levy ship money, a judgment overturned by the Long Parliament in 1640, which also declared the judgment contrary to the long held laws of the realm and the Petition of Right.

<sup>4</sup> Magna Carta, Article 40

<sup>5</sup> 'Direct Recovery of Debts, Consultation Document', 6.5.2014; HMRC:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/309624/Direct\\_Recovery\\_of\\_Debts.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/309624/Direct_Recovery_of_Debts.pdf)

<sup>6</sup> Full title: 'Enforcement by Deducting from Accounts', Schedule 1 of the Draft Clauses of the Finance Bill 2015: 10.12.2014, at p 470, Explanatory Note at 491:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/385160/Draft\\_clauses\\_and\\_explanatory\\_notes\\_for\\_Finance\\_Bill\\_2015.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385160/Draft_clauses_and_explanatory_notes_for_Finance_Bill_2015.pdf)

## Direct Recovery of Debts: the Draft Legislation

### The legislative framework

Creditors have long had the right to enforce debts through the transfer of funds held in their debtors' bank accounts. In law, a bank account is technically a debt owed by the bank to the holder of the account. Part 72 of the Civil Procedure Rules (the CPR) allows a court to order the payment by a third party (typically a bank) of unpaid judgment debts to a 'judgment creditor': that is, a person or company who has obtained a court judgment against the debtor that has not been paid.

Thus, for an individual or a company to obtain payment directly from their creditor's bank accounts, they must go through two legal procedures: they must firstly make a claim and obtain judgment before applying to the court (again) to enforce it under CPR Part 72. The taxpayer has the right to challenge first the claim and then the manner of enforcement in court.<sup>7</sup>

Both HMRC and other creditors may also issue bankruptcy or insolvency proceedings once a statutory demand has been served on a debtor, even without a court judgment. A debtor may challenge the statutory demand but if he does not (or the challenge is dismissed) the individual debtor will be made bankrupt or the corporate debtor wound up. Prior to or during any court proceedings, HMRC (as much as other creditors) may also ask the Courts for an injunction freezing a taxpayer's assets. While this may be imposed without notice to the taxpayer, he must be informed of it immediately and has the right to apply to discharge the injunction at any point.

The draft DRD clauses put HMRC in a special category. It may impose a 'hold notice' on a bank in the event that 'it appears to HMRC' that there is a debt to the Revenue.<sup>8</sup> This notice requires the bank to freeze funds up to the value of the debt less £5,000, which the Treasury claims will allow the debtor to cover day to day expenditure.<sup>9</sup> Objections may be made to a hold notice by both the taxpayer and the bank.<sup>10</sup> If these objections are not upheld, the taxpayer may appeal to the county court against the hold notice, as can the bank and an interested third party (for example, a joint account holder).<sup>11</sup> If there is no objection to the hold notice within the requisite period, there has been no appeal against HMRC's decision to dismiss the objection or an appeal has been dismissed by the court, HMRC may issue a 'deduction notice', requiring that the bank transfers the funds it requires and deducts them from the taxpayer's account.<sup>12</sup>

### Protections

Before a hold notice is issued, HMRC may require a bank to provide information about accounts held by a taxpayer.<sup>13</sup> However, this 'information notice' provides little additional protection to a

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<sup>7</sup> An interim third party debt order can be imposed by a court without notifying the debtor, which requires the bank to freeze funds in the account up to the value of the debt (CPR r. 72.4). However, the debtor must already be subject to a court judgment and must be served with the interim order and may make representations before the order is made final.

<sup>8</sup> Sched 1 para 4; see below in relation to Accelerated Payment Notices

<sup>9</sup> *Ibid*, paras 4 and 5

<sup>10</sup> *Ibid*, para 8

<sup>11</sup> *Ibid*, para 10

<sup>12</sup> *Ibid*, para 11

<sup>13</sup> *Ibid*, para 3

taxpayer, given that a hold notice issued on defective information (for example, against a bank where the taxpayer did not hold an account) would be defective in any event.

In its response to its consultation about the proposed DRD provisions, HMRC undertook to 'guarantee' that 'every debtor will receive a face-to-face visit from HMRC agents before their debts are considered for recovery through DRD'.<sup>14</sup> However, this does not form part of the draft legislation and merely appears in the Explanatory Note to the draft clauses.<sup>15</sup> The undertaking is therefore dependent on HMRC respecting it with no fear of sanction if it does not: a taxpayer would not be able to appeal against a hold notice on the grounds that he had not had a face-to-face meeting. In any event, there is no indication of who HMRC's agents would be, whether they would receive any training to identify vulnerable debtors or the extent of their 'duty' to establish face-to-face contact before issuing a hold notice. The Law Society has been heavily critical of the government's failure to write this protection into the statute.<sup>16 17</sup>

The most important protection for the taxpayer is the right to object to the issuing of a hold notice and to appeal to a court if HMRC overrule their objection. Grounds for objection and appeal include that the debt has been paid and that the hold notice was wrongly issued; but also that the notice is causing or will cause the appellant exceptional hardship or that there is an interested third party (for example, a joint account holder).<sup>18</sup> While an objection must be made within 30 days of the hold notice being served on the taxpayer,<sup>19</sup> there is no minimum period within which HMRC must consider and determine the objection.<sup>20</sup> The court has the power, once an appeal is made, to suspend a hold notice but it may do so only if a taxpayer provides security for as much of the debt frozen by the hold notice.<sup>21</sup>

## Criticism

### 'Relevant debts' and Accelerated Payment Notices

Paragraph 2 of the draft legislation sets out what is a relevant debt. A debt must be at least £1,000 and HMRC must be 'satisfied' that the taxpayer is aware that the sum is due. In most cases, the third condition is that the debt results from an assessment or decision or is imposed by statute and no appeal lies or it has been determined or not brought. If these criteria are not met, the hold

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<sup>14</sup> Direct Recovery of Debts, Summary of Responses, November 2014:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/377174/Direct\\_recovery\\_of\\_debts\\_-\\_Summary\\_of\\_responses.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/377174/Direct_recovery_of_debts_-_Summary_of_responses.pdf)

<sup>15</sup> After Sched 1, *ibid*, at para 3 on p 291.

<sup>16</sup> Direct Recovery of Debts – Draft Legislation; Law Society's Response, para 3.1:

<http://www.lawsociety.org.uk/policy-campaigns/consultation-responses/direct-recovery-of-debts/>

<sup>17</sup> The Government will publish fresh secondary legislation which may alter the statutory safeguards requiring face to face meetings, though it is unclear whether this provision will be amended at the time of going to press

<sup>18</sup> *Ibid*, paras 8 (3) (grounds of objections) and 10 (4) (grounds of appeals).

<sup>19</sup> *Ibid*, para 8 (5)

<sup>20</sup> No such provision is made in para 9, although the Commissioners may make regulations imposing time limits on consideration of objections pursuant to paras 18 and 19.

<sup>21</sup> *Ibid*, para 10 (10). The Court may also suspend a hold notice for one of several accounts if security is found for that as much of that account frozen by the hold notice: para 10 (10) (b); or so much of a part of any account as security is provided: para 10 (1) (c).

notice should be withdrawn by HMRC (on an objection being made) or must be overturned by the court (on an appeal against an objection not being upheld).

The exception to this is in the case of debts 'due under section 219 of [the Finance Act] 2014 [FA 2014] (accelerated payment of tax) or by virtue of a provision mentioned in sub-paragraph (6) (provisions which prevent the payment of tax being postponed)'.<sup>22</sup> Section 223 of FA 2014 provides for HMRC to issue an 'Accelerated Payment Notice' (APN) where three criteria are met:

- (a) a tax enquiry is in progress or the taxpayer has made a tax appeal which is underway;
- (b) the tax enquiry or appeal is on the basis of particular tax advantages; and
- (c) the tax enquiry or appeal relates to a scheme that is suspected to be an unlawful means of avoiding tax.<sup>23</sup>

If an APN has been issued, an objection or court appeal against the hold notice may not be upheld. Thus, under the DRD legislation HMRC may require a transfer of tax directly from a taxpayer's bank account before that taxpayer has had the opportunity to appeal.

There is, however, a lack of clarity in the draft DRD legislation as to when hold and deduction notices may be issued. Paragraph 2 (3) (b) provides that hold and (then) deduction notices may be issued when tax is 'due' under an APN. Section 223 of the FA 2014 provides that payment under an APN must be made 'before the end of the payment period'. The payment period is either 90 days after the APN is issued or, if the taxpayer makes representations to HMRC, 30 days after the taxpayer is notified that HMRC has rejected those representations (in whole or in part). The DRD legislation fails to state that a hold notice may not be made until after the end of the 'payment period' under s 223 FA 2014. Without this clarity, it would be for the courts to interpret whether the protection given to taxpayers issued with APNs applies. A taxpayer wrongly issued with an APN (and it is hardly unknown for HMRC to make administrative or substantive mistakes) may find his account subject to a hold notice without knowing (as it would be subject to the court's interpretation as to the meaning of 'due') whether he may challenge the final transfer of funds from his account. If the courts were to interpret 'due' in para 2 (3) (b) as any time after an APN was issued, no challenge to a deduction notice could be made even if the APN was flawed.

HMRC's right to issue APNs is itself a formidable executive power that requires the payment of tax before any tribunal has decided whether it is lawfully owed. In most cases, there can be no suggestion that those subject to APNs will have been attempting to 'evade' tax as HMRC will normally already be under notice of the taxation scheme being used. Terminology is important here: 'evasion' is the dishonest attempt not to pay tax that a taxpayer knows is lawfully due. While Parliament has given HMRC these powers in order to deal expeditiously with 'aggressive' tax avoidance, the limited safeguards provided by s 223 FA 2014 are the only protection provided to those wrongly issued with such notices. It is all the more important, in such circumstances, to

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<sup>22</sup> Sched 1, *ibid*, para 2 (3) (b).

<sup>23</sup> This may be for three reasons, set out in s 219: (a) because HMRC have issued a 'follower notice', indicating these suspicions, under the FA 2014 Pt 4; (b) HMRC has been notified of the arrangements under the Disclosure of Tax Avoidance Schemes rules pursuant to ss 306-319 of the FA 2014; and/or (c) it is the opinion of two members of the General Anti-Abuse Rule Advisory Panel (established by the FA 2014) that entering into those tax arrangements was not a 'reasonable course of action'.

ensure that that limited protection applies also to the direct deduction of monies from those taxpayers' bank accounts, setting aside all the other objections to the DDR legislation.

## **Delay**

As has been noted, the draft legislation fails to impose a time limit on HMRC's consideration of objections made to the imposition of a hold notice. The Commissioners have the power to make further regulations which might impose such time limits. There is, though, a significant problem in that the taxpayer may not appeal unless and until he is given notice of HMRC's decision to uphold a hold notice. Were time limits imposed, the primary legislation would still prevent an appeal until HMRC gave notice of their decision – even if they had breached such time limits imposed by regulations. While a taxpayer might apply for permission to judicially review (JR) HMRC's unreasonable delay in considering an objection, the JR process is itself time consuming and costly; where time is of the essence to a cash-strapped individual or business, this is no comfort at all.

Thus, a taxpayer on whom a hold notice is imposed would face a considerable delay before his objections (which might include, for example, an objection on the ground that his debt had been overstated and he had had insufficient time to challenge it) were able to be considered by a court. First, he may well have to take legal advice before filing an objection. Secondly, he would have to wait for HMRC to consider the objection. Thirdly, if the objection was not upheld and were appealed he would have to wait for a court to determine that appeal. The court process is itself likely to take months; many if the matter is complex. Even if security can be provided, no court has the power to suspend a hold notice unless and until HMRC have determined the objection.

## **Businesses**

'Persons' subject to DRDs include companies (which are legal persons). Companies have no greater protection than individuals, notwithstanding that the £5,000 immune from a hold notice may be a very small proportion of their day-to-day expenditure. Such companies – which might be struggling small and medium enterprises nevertheless employing many workers – could be subject to hold notices that would have the effect of causing immediate effective insolvency: they simply would not be able to pay their debts. In such circumstances, the ability to object and, ultimately, appeal against a hold notice may well be insufficient to prevent the company being wound up.

To use an example, Company A employs ten workers and has an annual turnover of £2,000,000. It is issued with a hold notice freezing £100,000. It disputes this liability but has no option but to issue an 'objection' to HMRC. This is not determined for three months. Company A has no ability to pay this sum and, even if it could provide security for it, it could not do so until its objection had been determined and it had appealed. Before an appeal to the court is open to it, Company A is unable to pay its debts and is wound up, causing its ten employees to lose their jobs.

## **Individuals**

In many cases £5,000 would be insufficient for individual taxpayers to meet their day to day expenditure. Were HMRC to take a similar period to determine an objection, these taxpayers may be unable to pay their rents, mortgages, credit card bills and so on before they have an opportunity

to challenge HMRC's decision to issue a hold notice in the courts – including in circumstances where (for example) the hold notice should never have been issued as the debt was not owed.

HMRC's 2014 Consultation<sup>24</sup> dismisses these concerns, assuming that it will only issue hold notices to those actually owing determined debts. It makes much play of the many interactions it will typically have had with taxpayers before a hold notice is issued. Yet a primary purpose of tax legislation is to provide taxpayers with *adequate* remedies against unfair or unlawful actions by HMRC. It must cater for circumstances in which the government is being *un*-reasonable. This draft legislation does no such thing. It allows the freezing of assets for an indeterminate period – quite possibly lasting many months – before a taxpayer has recourse to the courts to challenge an unlawful application. To use the words of Article 40 of the Magna Carta, it delays access to justice and replaces it (in the first instance) with an administrative procedure reliant on the good-will, competence and expedition of the Crown.

## Conclusion

The greatest legacy of the Magna Carta is the principle it established that the executive is subject to the law as much as the people. This paper has outlined many examples of the unfairness of the draft legislation and of the serious consequences it is likely to have in some cases. Yet the proposal is objectionable in principle. It places the Crown in a superior position to individuals and businesses in its rights to enforce debts. It denies access to the courts for the resolution of disputed tax liability before property is frozen; and delays a judicial remedy for an indeterminate period. Most dangerously of all, it treats individual property as the property of the state once the state has determined it so.

The relationship between government and governed is one dependent on a respect for due process and for property. HMRC has as much right as any other creditor to enforce its debts once they are established in Court, where a debtor has the same rights against both. It would be wrong in principle for this balance to be disturbed.

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<sup>24</sup> HMRC Consultation Document, *ibid*.