

# Can't pay? Won't pay?

## Using bankruptcy for council tax debts

Focus Report: learning the lessons from complaints

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## Introduction

Some 350 councils have a statutory duty to levy and collect council tax on almost 22.7 million domestic properties. The total council tax billed for 2010/11 was £21.9 billion and the national average in-year collection rate was 97.3%.

About a quarter of the money councils have to spend on local services comes from council tax. When people don't pay, councils have two imperatives to collect tax and recover debts – the need for revenue vital for funding local services and the consequences of failing to enforce, equally, on all citizens the legal and social obligation to pay taxes.

The Local Government Ombudsmen consider complaints by citizens who claim injustice caused by maladministration or failings in services. Although the total numbers are small, we have published reports in an unusually high proportion of the complaints made to us from people made bankrupt by councils for council tax debts. A common theme in these cases is flaws in the way the councils decided to pursue bankruptcy.

Legislation sets out what councils can do to recover council tax debts including seeking imprisonment or bankruptcy – with potentially severe consequences for the individuals in debt. The latest available statistics show that in 2009/10 councils initiated at least 4,700 bankruptcy proceedings to recover council tax debts.

Councils have the lawful power to pursue bankruptcy orders against people who will not pay their council tax debts. The Ombudsman will not criticise a council for using bankruptcy and other debt recovery methods if the decision to do so has been properly made.

Maladministration in making someone bankrupt can have devastating consequences for the individual citizen and the financial costs to councils of remedying injustice can be high.

Based on our experience of complaints, we have produced this Focus report to help councils avoid maladministration when using their powers and to enable agencies that advise on debt to identify cases that should be referred to us.

October 2011

# Collecting council tax and recovering debt – a summary

When collecting debts, councils are in a unique category for two reasons:

1. public policy consideration of:

- > fairness to those citizens who do pay, and
- > the consequences for overall payment levels if non-payers are allowed to evade their debts.

2. public law requirements to:

- > act fairly, proportionately and within the law
- > make decisions properly, and
- > comply with general statutory duties in relation to disabled people, including those with a mental impairment.

The Local Government and Finance Act 1992 and the Council Tax (Administration and Enforcement) Regulations 1992 set out councils' powers to collect and recover council tax. Adults living in a domestic property are liable to pay council tax and there is a system of discounts, exemptions and benefits for some people in specified circumstances. A council can reduce council tax on a particular property to nil if it sees a good reason to do so.

The process and powers for collecting council tax and recovering debts can be summarised as:

- > Every council tax payer is sent a demand at the beginning of the financial year and has the right to pay this by monthly instalments.
- > If the instalments are not paid, councils can pursue recovery by serving at least one reminder (or a final notice for arrears).
- > If the arrears are not paid after a reminder, the full council tax for the year falls due and the right to pay by instalments is lost. Councils can then apply to the magistrates' court for a liability order.
- > If the magistrates make a liability order and the debt is not paid, councils can:
  - make an attachment of earnings order, or
  - apply for deductions from the debtor's income support, or
  - levy distress on the debtor's goods to sell and clear the debt with the proceeds, or
  - apply to the county court (or the High Court in London) for a charge to be put on a property on which a council tax debt of more than £1,000 is owed, if it is owned by the debtor, or
  - apply to the county court (or High Court in London) for the debtor to be made bankrupt if it has a liability order for a debt of more than £750.
- > If distress on goods has been attempted and failed, councils can apply to the magistrates' court to have the debtor committed to prison.

## Limitations and implications of recovery methods

Attachment of earnings can only be used if the debtor is in work and can be difficult to maintain if debtors change employers or move in and out of employment.

Deductions from benefit will recover a debt very slowly and may not be made if deductions are already being made for another debt.

If distress has failed and a council applies to the magistrates' court for the debtor to be committed to prison, the magistrates will inquire into the debtor's means. A warrant for the debtor's committal can only be issued if the magistrates are satisfied that failure to pay the council tax is due to the debtor's 'wilful refusal or culpable neglect'. If the debtor is imprisoned the council is precluded from taking any further steps to recover the debt.

An application to put a charge on a property can only be made if a council tax debt of over £1,000 has been incurred on that property. This secures the debt but it is not paid until the property is sold (but meanwhile attracts interest). When the property is sold any mortgage debts take priority and the sale may not raise enough to clear the council tax debt. Councils can apply to the court for a forced sale. This incurs additional costs to be paid from the proceeds of the sale and councils have to administer the sale.

A council can start bankruptcy proceedings if it has a liability order for a council tax debt of more than £750. The first step is to serve a statutory demand, explaining the debt that is being recovered. A debtor can ask the county court to set the demand aside on specified, limited grounds (for example that the debt is not owed). If the debt remains unpaid after 21 days and no arrangements to clear it have been agreed, a bankruptcy petition can be served in the court asking for the debtor to be declared bankrupt. The debtor will be liable to pay the council's costs.

Once the court makes a bankruptcy order, the Official Receiver can appoint a licensed insolvency practitioner as a trustee to safeguard and secure the assets of the debtor for the benefit of creditors generally. A debtor's assets can be sold to settle the debt. Trustees are entitled to payment out of the proceeds for their costs in managing the estate.

A county court can annul a bankruptcy order on the basis that the order should not have been made or that the debts and the expenses of the bankruptcy have been paid or secured.

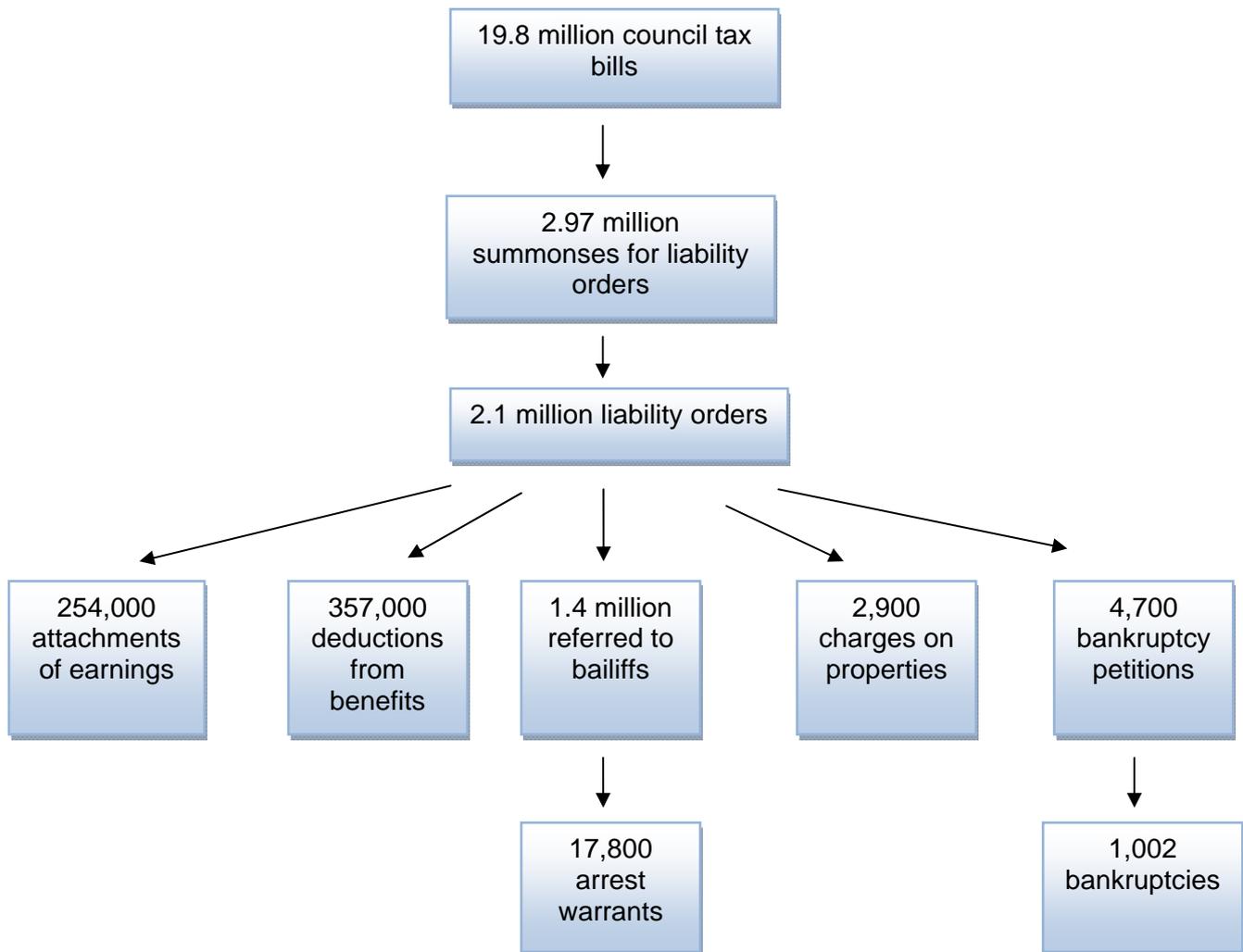
## Recovering council tax

Individuals may not pay their council tax for a variety of reasons:

- > having to juggle bills and debts in order to 'make ends meet' with very low income
- > financial problems precipitated by a personal crisis
- > lack of life skills and inability to cope
- > as a form of protest, or
- > from hostility to 'officialdom'.

Whatever the reasons for non-payment, it is important for councils to have effective approaches to collecting and recovering this important source of revenue.

The diagram below shows the numbers for 2009/10<sup>1</sup> involved in each step and indicates the success of each measure in bringing debtors to make arrangements to pay (numbers are rounded). It is widely acknowledged that people in debt will respond to the creditor who is pressing hardest at a particular point. When people in debt seek independent help advisers will give council tax debts priority along with those where the ultimate sanction for non-payment is loss of home, disconnection, or imprisonment.



## Use of bankruptcy and complaints to the Local Government Ombudsman

Councils have made more use of bankruptcy proceedings over the years. In 1992/93 local authorities in England and Wales were petitioners in less than 1% of bankruptcy proceedings brought by creditors. By 2007/08 that figure had risen to 20%<sup>2</sup>.

Returns from councils for the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Annual Revenue Collection Statistics, show that in 2009/10 councils initiated 4,732 bankruptcy proceedings to recover council tax. Eight councils accounted for 70% of these proceedings.

### Factors to consider

In making decisions about using bankruptcy to recover council tax, councils need to take account of and balance various factors, including:

- > costs, effectiveness, and other implications of bankruptcy
- > the individual circumstances of the debtor

- > general equality duties
- > implications for overall payment levels if people come to believe that council tax debts will not be collected
- > impact of non-payment on revenues and the ability to deliver services to the community, and
- > equality between those who do pay and those who don't.

The relative weight and balance of these factors is a matter for each council. In some complaints we have found that there has been no policy framework for officers to work in or guidance provided about what weight to give to the factors. There have also been failures to record how these factors have been taken into account and balanced.

As might be expected, it seems harder to collect council tax in poorer areas – collection rates in the 10 least deprived council areas range from 98.4 % to 99.3% and in the 10 most deprived areas the range is from 92% to 97.3%.

The importance of collecting council tax is illustrated by the fact that, amongst the 10 most deprived areas, almost £6 million additional revenue would be available each year to the council with the lowest collection rate if it could match the performance of the council with the highest collection rate.

### Case study – the need for a policy and a balanced decision

Mr J and his wife were jointly liable for council tax on their home. The amount they had to pay varied depending on changes in their entitlement to benefits, Mrs J's employment status and when their son lived with them. The council pursued Mr J for a total council tax debt of £1,071 over five years varying from £45.70 to £556.82 each year. Mr J disputed that he owed what the council claimed but, for a time, made regular payments towards the arrears. Those payments were put to the current year's liability and a delay in the council introducing a new computer system meant that he was not contacted about the earlier arrears.

When Mr J's regular payments stopped, the council sent him a letter saying that it would begin bankruptcy proceedings unless he paid all that he owed. Mr J said that he did not receive that letter, the statutory demand or the bankruptcy petition. The court declared him bankrupt in his absence.

The Ombudsman found that the council had explained why Mr and Mrs J owed the sums it claimed, that Mr J should have known that the biggest part of the debt was for a period when he could not show that he had made payments and that his claims not to have received various official notifications were not credible.

The Ombudsman also acknowledged that the council's council tax collection rates had improved since it began to use bankruptcy, but said:

*I regard it as a fundamental flaw that the council should have been using [bankruptcy] without a written policy for officers to refer to in individual cases. While the council may not have been under a legal requirement to have such a policy, I consider it maladministration for an authority not to have such a policy for the guidance of its staff in such an important area of public administration. I say this because the consequences of bankruptcy can be devastating to the debtor in terms of both the loss of assets and the costs that can multiply the debt many times over. These consequences are such that I consider the council must consider the appropriateness of such recovery action in each individual case where it is used... I find that the council's actions in this case are insufficient to demonstrate that it properly took account of Mr J's circumstances, properly considered alternative courses of recovery, or gave adequate due warning before choosing the route of bankruptcy...*

## Case study – taking account of costs

A council pursued Mr F for a council tax debt of £839.43.

The bankruptcy process incurred costs of approximately £38,000 including VAT, legal costs of £2,260, trustee's costs of £13,459 and trustee's legal costs of £13,373 together with the disbursements and the costs of the Official Receiver.

The Ombudsman said:

*The council cannot, it seems to me, turn a blind eye to the consequences to the debtor of any recovery option it pursues. Some courses will no doubt be administratively more convenient and less costly than others. But in selecting these options the impact on the debtor should be weighed in the balance. The dire and punitive consequences of bankruptcy, involving a multiplication of the debt many times over and frequently incurring the loss of the debtor's home must be factor to be taken into account ... I have seen no evidence that this relevant consideration was taken into account ... that was maladministration.*

## Case study – taking account of the debtor's circumstances

Mr C complained to the Ombudsman that a council was going to make him bankrupt for council tax debts.

The investigation showed that Mr C owed £6,000, had paid £600 over the previous nine years, had not kept to various arrangements to pay and had not claimed benefits, although he had been encouraged to do so. There was nothing to suggest that Mr C was disabled and there was equity in his property. The council had a policy on using bankruptcy and had followed it.

The Ombudsman found no fault in the council's decision to apply for Mr C to be made bankrupt.

## General equality duties

Since December 2006, councils have been under a duty to carry out their functions with regard to: "...the need to take steps to take account of disabled persons' disabilities, even where that involves treating disabled persons more favourably than other persons"<sup>3</sup> and to take "reasonable steps" to change any policy, procedure or practice that makes it "...unreasonably adverse for disabled persons to experience being subjected to any detriment to which a person is or may be subjected, by the carrying-out of a function by the authority"<sup>4</sup>.

Similar provisions are contained in the Equality Act 2010 that came into force in autumn 2010:

- > Section 15 says that a disabled person is discriminated against if they are treated less favourably because of something arising in consequence of their disability and the public authority cannot show that the treatment is a proportionate way of achieving a legitimate aim.
- > Section 19 provides that indirect discrimination occurs when a policy that applies in the same way for everybody has an effect that particularly disadvantages disabled people.

- > Section 20(3) creates a duty “...where a provision, criterion or practice ...puts a disabled person at a substantial disadvantage ... in comparison with persons who are not disabled, to take such steps as it is reasonable to have to take to avoid the disadvantage.”

Councils must have regard to these duties when collecting and recovering council tax.

### Case study – the need for information about the individual

Mrs G suffered from long-term, severe mental illness and was known to, but refused support from, a community mental health team. She became involved in litigation with a bank over a mortgage. The court appointed a member of the community mental health team (and employee of Mrs G’s council) and then, later, the Official Solicitor as Mrs G’s Litigation Friend. Mrs G’s sister wrote to the council’s social services department with concerns about her mental health and financial welfare and asking for co-ordinated action from the council.

In parallel, and separate to Mrs G’s litigation with the bank, the council’s council tax section had been trying to recover some £5,000 of council tax arrears. Numerous attempts to contact Mrs G had failed and, not knowing of her mental illness, the council applied to have Mrs G declared bankrupt and a Trustee in Bankruptcy was appointed.

By then the bank and the Official Solicitor (acting as Mrs G’s Litigation Friend) had reached an agreement to settle the litigation over the mortgage. The bankruptcy meant that the agreement could not be implemented as the Trustee in Bankruptcy controlled Mrs G’s assets. When the Official Solicitor made contact the council tax section became aware of Mrs G’s illness. An officer recorded that if the section had been aware, bankruptcy action would never have been taken.

The council told the Ombudsman that the council tax officer who decided to pursue bankruptcy had checked the council tax and benefit records, correspondence and bailiff’s reports and considered alternative recovery methods. He had not recorded these checks. The council questioned whether it would be reasonable to expect the officer to have conducted an unsolicited check with social services.

The Ombudsman found that the failure to record checks and the reasons for not pursuing alternative recovery methods was maladministration and said:

*Part of the council was aware that [Mrs G] had a mental health difficulty and was unable to conduct her own affairs. The failure to make effective internal enquiries led to unwarranted action against a clearly vulnerable lady...If a council chooses to use bankruptcy to collect a local taxation debt it should make all reasonable checks of the information it has to establish that the debtor is not vulnerable. Given the possible consequences of bankruptcy I do not think it unreasonable for Revenue Officers to look beyond their own departmental information and consider a council’s records as a whole...*

The equality duty and mental health are particularly relevant to council tax debt recovery because:

1. Mental impairment can be a disability if it has a substantial and long-term adverse effect on someone’s ability to carry out normal day-to-day activities.
2. People suffering from a severe mental impairment can be entitled to a reduction in council tax<sup>5</sup>.

People with mental illness tend to have higher levels of debt than those who are well – 24% of people with depression and anxiety (a common mental disorder) and 33% with psychosis experience higher levels of debt<sup>6</sup>.

The link between debt and mental health is recognised by the private consumer finance industry, the Royal College of Psychiatrists, the Royal College of General Practitioners, the Money Advice Trust, MIND and

other charities. Advice and guidance to the industry, social care and health professionals have been published, including *Good Practice Awareness Guidelines for Consumers with Mental Health Problems and Debt* published by the Money Advice Liaison Group<sup>7</sup> that brings these interest groups together.

## Powers to gather information about individuals

The Council Tax (Administration and Enforcement) Regulations 1992 govern what information Council Tax billing authorities can seek for the purposes of recovering council tax debts – a billing authority can only ask another authority for information about someone’s name, address, previous addresses and dates when they lived at those addresses, but can use any information that it holds under any of its other powers.

Information about a person’s mental or physical health is sensitive personal data and cannot be disclosed except with their consent or some other, limited, circumstances<sup>8</sup>.

The Information Commissioner has said that he will avoid an over restrictive application of the law where that would lead to organisations failing to make sensible use of the information they hold<sup>9</sup>.

The Information Commissioner has issued guidance that information held by different council departments can be shared between those departments, as long as it is not for a completely separate and unrelated purpose and data protection principles are applied<sup>10</sup>. The guidance says that local authorities should be open and transparent about all the probable reasons for which such data may be used.

We take the view that, provided these principles are adhered to, sensitive personal data can be shared within a billing authority, for example a unitary authority that is both the council tax and social services authority.

## Avoiding maladministration in council tax recovery

### We are likely to find maladministration if a council:

- > **does not have a formal, published Debt Recovery Policy covering bankruptcy, committal to prison or charging orders**
- > **has not gathered and considered information about an individual debtor’s circumstances**
- > **does not include in its Debt Recovery Policy the steps officers must take before deciding on bankruptcy, committal to prison or charging orders, or**
- > **pursues bankruptcy without clearly recording that each of these steps has been taken and making a record of each outcome.**

In developing a Debt Recovery Policy a council must, by law, consider whether its recovery practice would particularly disadvantage a disabled person; and, if so, what steps can be taken to avoid the disadvantage.

We expect Debt Recovery Policies to set out when decisions about recovery measures should be based on consideration of an individual debtor’s circumstances and the information that the decision maker should consider. This will depend on a combination of practicality and the impact of the recovery measure on the debtor – it would not be practicable for a council to consider individual circumstances when issuing reminders or summonses for liability orders (but a council that already has information about individual circumstances that might affect such decisions should ensure that it is taken into account).

Given the draconian consequences for individuals, we are likely to find maladministration if a Debt Recovery Policy does not require:

1. Council officers to have made reasonable efforts to contact the debtor in person, including visiting their home if necessary.
2. A senior officer to have decided that pursuing bankruptcy is a fair and proportionate action after:
  - > reviewing an accurate history of the origin of the debt and attempts to recover it
  - > considering information about the past, present, disputed or outstanding benefit claims or any discounts or exemptions that might be relevant
  - > assessing that the debtor has assets that will clear the debt if bankruptcy is pursued
  - > assessing that there is no realistic prospect of recovering the debt by other means in a reasonable timescale
  - > gathering sufficient evidence about the debtor's circumstances
  - > considering whether a debtor's failure to pay and to respond to other recovery measures could arise from a disability (including a mental impairment with a long-term and substantial effect on normal day-to-day activities), and
  - > considering whether the debtor's personal circumstances warrant them being protected from the consequences of recovery action.

Visits to a debtor's home to levy distress are an opportunity to gather information and a council's expectations about what should be recorded by its own staff or bailiffs should be set out in its Debt Recovery Policy.

Decisions about pursuing bankruptcy, seeking committal to prison or applying for a charging order should be recorded and the records retained<sup>11</sup> together with the information considered by the decision maker.

Written information should to be provided to the debtor when bankruptcy proceedings are being considered. That information should:

- > warn the debtor of the serious consequences of bankruptcy and their continued failure to make arrangements to pay the debt, and
- > urge them to seek independent advice and 'sign-post' to local sources of advice.

## Further information

### Sources of help

There is no statutory guidance to councils about the use of debt recovery measures. In developing debt recovery policies, we commend councils to consider the publications produced by Citizens Advice, MIND, and particularly:

- > *Collection of Council Tax Arrears Good Practice Protocol* agreed between the Local Government Association and Citizens Advice in July 2009, and
- > The Money Advice Liaison Group's (MALG's) *Mental Health Good Practice Awareness Guidelines*<sup>7</sup> for the industry concerned with consumer credit and debt.

## A note on the Ombudsman's jurisdiction

The Local Government Ombudsman cannot investigate the 'commencement or conduct' of proceedings in any court of law but can investigate a councils actions before court proceedings start. In the case of bankruptcy this is when a bankruptcy petition is served.

The Ombudsman should not investigate a complaint if the person affected has or had an alternative remedy by way of proceedings in any court of law unless the Ombudsman is satisfied that it is not reasonable to expect the person affected to use such proceedings. There is a right to apply for an annulment of a bankruptcy order as part of a defence to bankruptcy proceedings. The Ombudsman does not see this as an alternative remedy by way of proceedings in a court of law.

Visit our website at: [www.lgo.org.uk](http://www.lgo.org.uk)

See our fact sheet on complaints about bankruptcy at:  
[www.lgo.org.uk/publications/fact-sheets/complaints-about-bankruptcy/](http://www.lgo.org.uk/publications/fact-sheets/complaints-about-bankruptcy/)

If you have a complaint you would like to make about your local council, you can contact us on:  
0300 061 0614.

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- 1 Annual Revenue Collection Statistics, Chartered Institute of Public Finance and Accountancy.
  - 2 *The Times* 7 January 2009. Not all these petitions will have been about council tax debt.
  - 3 Section 49A Disability Discrimination Act 1995 introduced by Section 3 of the Disability Discrimination Act 2005.
  - 4 Section 21E Disability Discrimination Act 1995 introduced by Section 2 of the Disability Discrimination Act 2005.
  - 5 Section 11 and Schedule 1 Local Government Finance Act 1992.
  - 6 Jenkins R, Bhugra D, Bebbington P, Brugha T, Farrell M, Coid J, Fryers T, Weich S, Singleton N, Meltzer H (2008). *Debt, income and mental disorder in the general population*. *Psychological Medicine* 38, 1485-1494.
  - 7 [www.malg.org.uk](http://www.malg.org.uk)
  - 8 Data Protection Act 1998 Section 2.
  - 9 *Sharing Personal Information – Our Approach* Information Commissioner's Office, April 2007.
  - 10 *Data Protection Good Practice Note – Data sharing between different local authority departments* Information Commissioner's Office, June 2008.
  - 11 In accordance with the council's information security and retention policies.