

Be reasonable

RAY MCCANN and **CATHYA DJANOGLY** consider the extent to which HMRC's view of 'reasonable excuse' has been supported by the First-tier Tribunal.

In 2009, the most significant change to the powers available to HMRC to charge penalties for errors in tax returns for more than 30 years became law. This has been followed by substantially increased penalties for late payment of tax coming into effect in April 2011. Also in 2011, the 2009 penalty regime was itself amended so that where the error or delay relates to income or gains arising in an offshore jurisdiction, the penalties that can be charged are increased to a maximum of 200% of the unpaid or late paid tax.

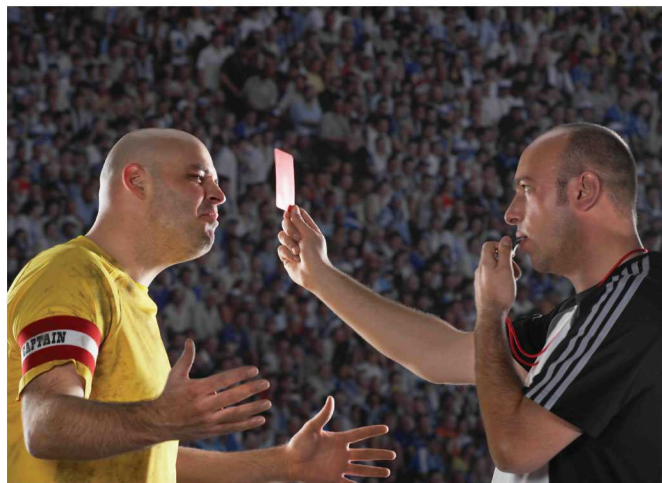
At the time of the review of HMRC powers, Simon Norris then head of HMRC's powers team commented that the 'objective of the review of penalties was to change the behaviour of taxpayers and also the behaviour of HMRC staff'. This was generally taken to mean that there would be an end to what Dave Hartnett had previously referred to as the 'penalty free zone' enjoyed by big business, and it was predicted that the new penalty regime would inevitably mean more penalties that would, on average, be in higher amounts than in the past. This expectation was encouraged by HMRC's pronouncements that this would be an outcome. Few would, however, have expected to see just over two years later what verges on a full scale assault by HMRC on the few protections available to taxpayers.

Criticisms of HMRC practice

Over the past two years it has become clear that HMRC have been taking an extremely severe stance on those who have failed to comply with their obligations, and inspectors have been

KEY POINTS

- HMRC are taking a severe stance on those who have failed to comply.
- Parliament did not define 'reasonable excuse', so what is it?
- HMRC increasingly exercise powers with little oversight.
- A review of reasonable excuses and tribunal decisions.
- There is an urgent need for HMRC to rationalise the guidance.



reluctant to accept that there was a 'reasonable excuse' unless some exceptional circumstances were present. They have also rarely accepted that a penalty should be reduced to take account of 'special circumstances'.

Leaving aside how HMRC approach these protections, it seems that they have, on occasion, also deliberately waited before informing taxpayers that they are liable to a penalty, thereby increasing the amount of the penalty payable – see in particular *Hok Ltd* TC1286 and *HMD Response International Ltd* TC1322. The First-tier Tribunal has harshly criticised this practice and in a string of recent cases on penalties it has refused to uphold the penalty charged, giving the authors hope that HMRC will be compelled to change their practices. Not only have HMRC been criticised for not interpreting the law on 'reasonable excuse' correctly, they have also been reminded that as a public body they have a duty to act fairly. Some of the cases covered in this article show that HMRC may have come close to breaching this duty, although it is suspected that these examples reflect individual failings only.

The statutory provisions on reasonable excuse are long-standing and a taxpayer is protected from a penalty for failing to meet a tax obligation where that person has a reasonable excuse and the failure is remedied within a reasonable time after the reasonable excuse has ceased (TMA 1970, s 118(2)). But, and herein lies one of the difficulties, what precisely is a reasonable excuse? Parliament has not defined it. In recent months the First-tier Tribunal has stressed that these are ordinary English words to be given their ordinary meaning. In short, it is a reasonable excuse and not, as HMRC has contended an 'exceptional excuse'.

Tax Bulletin 34

So where are we with 'reasonable excuse'? Understanding HMRC guidance is a daunting task as they have guidance across all of their taxes and then guidance within the guidance. *Tax Bulletin 34* provides the most exhaustive guidance on HMRC's

interpretation of the phrase.

Clearly, HMRC envisage 'reasonable excuse' applying only in the most extreme cases and such an excuse as existing only where 'in general', they see the reasonable excuse as 'an exceptional event beyond the taxpayer's control, which prevented the return from being sent back by the deadline or the tax being paid by the due date'. The bulletin contains examples of circumstances which, in HMRC's view, constitute 'reasonable excuse'. Most of them belong to the sphere of acute human drama or even tragedy: fire, flood, theft, serious illness and death of a close relative or domestic partner.

Overall, the tribunal has had no sympathy with HMRC's attempts to rewrite the statutory provisions and while this is helpful, many taxpayers have found that obtaining expert help has been problematic since the cost of pursuing an appeal may in many cases negate any benefit even if it is successful. This is of great concern, especially since it is increasingly the case that HMRC are able to exercise their extensive powers with no independent oversight.

The legal safeguards open to taxpayers to challenge decisions of HMRC not only protect taxpayers, they also ensure the effectiveness of the statutory provisions which HMRC depend upon to encourage compliance. Where taxpayer protection is non-existent, or at a practical level of no value, then the very legality of the statutory provisions is inevitably called into question.

As matters stand it seems clear that the tribunal would take the view that a reasonable excuse existed in the following situations:

- postal delays;
- where HMRC's advice has been relied upon;
- where an adviser has been relied upon; and
- where the taxpayer has insufficient funds.

Postal delays

HMRC's guidance – which seems often to be implemented to the letter by HMRC staff – is that postal delay will only constitute a reasonable excuse if the local post office has been washed away in a flood, destroyed by fire or the postmen have gone on strike.

The tribunal has, however, emphasised that a taxpayer who has posted his return allowing enough time for it to reach HMRC does have a reasonable excuse where the return does not reach HMRC on time and it is time that HMRC adopted the tribunal approach in their guidance.

Two recent decisions are of particular interest. In *C Runham and Ms C Naramore* TC933, the taxpayer's solicitor allowed ample time for an stamp duty land tax return to reach HMRC which despite this still sought a penalty. The First-tier Tribunal dismissed the penalty on reasonable excuse grounds.

The tribunal reached a similar decision in *AT Davies* TC1165, where the taxpayer had allowed more than four clear days for his return to reach HMRC. In contrast, in *GV Cox Ltd* TC1172 the taxpayer posted the return to HMRC so close to the deadline that there could be no reasonable expectation that it would arrive on time and so the tribunal found that the taxpayer did not have a reasonable excuse.



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Reliance on HMRC advice

In *Colin Humphreys* TC974, the taxpayer had relied on an HMRC online filing advertising campaign and had set out to file his return online expecting to be able to use HMRC's online filing facility. He discovered that he required additional software (a fact not highlighted by the advertising campaign) and so filed a paper return after the deadline (31 October). The First-tier Tribunal found that the taxpayer had a reasonable excuse and that HMRC had been wrong to impose a penalty.

Similarly, in *Dental IT Ltd* TC1002, reliance on advice given by the staff manning an HMRC helpline was found to be a reasonable excuse.

Finally, in *NA Dudley Electrical Contractors Ltd* TC1124, HMRC's failure to send the taxpayer a paper return was considered to be a reasonable excuse. Similarly, in *Tower Leasing Ltd* TC1334, the First-tier Tribunal found that the taxpayer had a reasonable excuse for failing to file his return online, given that HMRC had mistakenly sent him a paper return. However, the tribunal also pointed out that the failure to read HMRC publications sent to the taxpayer could not in itself constitute a reasonable excuse.

Reliance on an adviser

Again, there are important points in how the First-tier Tribunal have dealt with failure by an adviser. In *A Leachman (t/a Whiteley & Leachman)* TC1125, the taxpayer had not filed his annual PAYE return form P35 under the mistaken belief that his accountant would do so. Again, the tribunal concluded that this was a genuine mistake and this could constitute a reasonable excuse.

A similar result ensued in *Tower Perkins Products & Services Ltd* TC1328 where the unforeseen hospitalisation of the taxpayer's agent was accepted as a reasonable excuse. In *S Rich* TC1380, a more recent case, the taxpayer relied on his accountant to register him with HMRC for tax purposes and was held to have a reasonable excuse for the late submission of his return when the accountant had failed to do so.

Interestingly, HMRC contended that Mr Rich had failed to exercise 'reasonable foresight and due diligence'. This could be an indication that HMRC are changing tack and putting less reliance upon being able to show that the taxpayer had no reasonable excuse although it may be too early to tell whether the wind is changing within HMRC and they are coming to the realisation that their interpretation of 'reasonable excuse' may in many situations be untenable.

That each case must be considered on its merits is demonstrated by the decision in *Peter Boote Ltd* TC1150, where the facts were very similar to those in *Leachman* above. The taxpayer had not filed his end of year PAYE return thinking that his accountant had done so, but in seemingly complete contrast to the decision in *Leachman*, the FTT found that the taxpayer did not have a reasonable excuse in such circumstances.

Insufficiency of funds

In the current economic difficulties, an insufficiency of funds has caused problems for many taxpayers and this has inevitably

impacted upon their tax compliance. In general, not having funds to meet a tax liability will not usually be a reasonable excuse. However, the underlying causes may give rise to a reasonable excuse especially where the cause appears at short notice so all of the facts should be fully explained.

In *Miss M Barron* TC1329, the First-tier Tribunal concluded that a lack of funds due to having to carry out repairs was a reasonable excuse.

Similarly, in *Paul Hoskins Ltd* TC1385, the taxpayer's financial difficulties had been caused by the sudden reduction of a debt-factoring facility by the taxpayer's bank. The tribunal found that the taxpayer had a reasonable excuse for the late payment of tax.

However, in *Mrs J Goldwater* TC1330, the tribunal found that an elderly taxpayer who had used all her available liquid funds to pay for 24-hour care did not have a reasonable excuse for non-payment of her tax. This was on the basis that no evidence had been produced to show that the taxpayer had explored possible sources of funds. Interestingly, the tribunal does not seem to have applied this test in the *Barron* case, referred to above.

Conclusion

Despite the concern expressed above, most penalties imposed by HMRC appear to be accepted by taxpayers, and a majority of the appeals made by taxpayers have been dismissed or allowed only in part by the First-tier Tribunal. Nevertheless, too many penalties have been imposed in situations where a more objective HMRC approach would have resulted in either no penalty at all being due, or a much lower penalty being charged.

HMRC have a duty to taxpayers to ensure that compliance is as straightforward as possible and while there is a limit on what HMRC can reasonably be expected to do, taxpayers are entitled to have confidence that HMRC will consider any failure to comply (with often highly complex requirements) on its individual merits.

This is especially so in situations where even relatively minor 'tax offences' can result in very substantial financial penalties and the cost of obtaining professional help to dispute the penalty may exceed the amount of penalty charged.

So far as reasonable excuse is concerned, there is an urgent need for HMRC to rationalise their guidance and preferably their various, sometimes inconsistent, guidance should be replaced with a single source of guidance that is applicable in all situations where reasonable excuse is appropriate.

This updated guidance must have regard to the approach of the First-tier Tribunal. Equally, as in other situations where HMRC discretion is in point, there should be a presumption that discretion is to be exercised in favour of the taxpayer unless the facts and circumstances clearly point to a different outcome.

HMRC will have no reasonable excuse for failing to do otherwise. ■

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