Reasonable care and excuse

Management of taxes | Personal tax



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Kugan Panchalingam and Justin Cobb consider what the terms reasonable care and excuse mean in practice

Key Points

What is the issue?

HMRC has the right to assess penalties where an individual has failed to give notice of chargeability to tax or where a tax return already submitted contains an inaccuracy.

What does it mean for me?

Penalties can be significant, especially for offshore failures. It is important to consider whether the taxpayer can successfully demonstrate that they have a reasonable excuse, or have not been careless, for their failure to disclose income and gains.

What can I take away?

It may be in the best interest of the taxpayer to consider an independent review and alternative dispute resolution if appropriate. Each case should be reviewed on its own merits.

Since the introduction of the Requirement to Correct (RTC) legislation and the ongoing development of worldwide automatic exchange of information systems, advisers have been receiving unprecedented levels of enquiries from individuals.

Often, it is a simple case of the taxpayer not having reported bank interest. The figures tend to be insignificant in the taxpayer’s overall context and cases are quickly disclosed and agreed. At times, however, the offshore structure and the history leading up to the non-compliance can be very complex.

Penalties as applied to onshore and offshore matters can be substantial. It is therefore important to consider whether the taxpayer can successfully demonstrate that they have a reasonable excuse, or have not been careless, for their failure to disclose income and gains, irrespective of whether this relates to offshore or onshore matters.

This article considers what exactly these terms mean and how they operate in practice.

The principles

Penalties may be assessed where an individual has failed to give notice of chargeability to tax or where a tax return contains an inaccuracy. In the case of a failure to notify, HMRC can assess up to 20 tax years, even if the behaviour that led to the delinquency was not deliberate or fraudulent. This is reduced to four tax years where the individual has a reasonable excuse for a failure to notify HMRC.

Where the individual has already been filing tax returns but those returns contain errors, HMRC's ability to assess tax is again driven by the behaviour of the client, and are as follows:

- Failure despite having taken reasonable care: four tax years;
- Carelessness: six tax years; and
- Deliberate and/or concealed: 20 tax years.

In relation to offshore matters, the failure to notify penalties, and penalties in respect of an inaccuracy can range from 0% up to 200% (depending on the country involved, the length of time that has elapsed and behaviour, etc.). Penalties can be limited to 0% and the time period can be reduced to four years where the taxpayer can prove a reasonable excuse for the failure to notify, or reasonable care in preparing tax returns.

Under the Requirement to Correct legislation, any delinquency in relation to the tax years 2015/16 and earlier involving offshore matters or transfers generate automatic penalties of 200%, which can be reduced to between 100% and 150% in some cases.

Although reasonable care and excuse appear to be very simple words, it has been found on many occasions that HMRC's interpretation can be narrow.

Reasonable excuse and care: HMRC's interpretation

The legislation does not define these terms, meaning they should be interpreted in plain English. HMRC in its Compliance Handbook (CH26340) provides its view:

'HMRC considers reasonable excuse to be something that stops a person from meeting a tax obligation despite them having taken reasonable care to meet that obligation. It is necessary to consider what a reasonable person, who wanted to meet their obligation, would have done in the same circumstances and decide if the action of the person met that standard as outlined by Judge Medd in The Clean Car

Company (LON/90/138X).

‘“One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?”

‘Whether a person has a reasonable excuse will depend on the particular circumstances in which the failure or obstruction occurred and the abilities of the person who has failed. What is a reasonable excuse for one person may not be a reasonable excuse for another person.’

HMRC’s definition of ‘carelessness’ is the failure to take ‘reasonable care’. HMRC guidance (CH81140) states:

‘People do make mistakes. We do not expect perfection. We are simply seeking to establish whether the person has taken the care and attention that could be expected from a reasonable person taking reasonable care in similar circumstances, taking into account the ability and circumstances of the person in question at the time the irregularity was submitted to HMRC.’ (author’s emphasis)

Very wealthy individuals often rely on professionals to help them manage their affairs; for example, in wealth management and tax compliance. Their appointed advisors may have a deeper understanding of their clients’ affairs than the clients themselves.

Errors can still occur, however. For example, in the case of a US Family Office managing the affairs of a wealthy American individual who resides in the UK. The tax returns may be prepared by a UK firm. Perhaps, due to the unfamiliarity in the US with the concept of remittance basis taxation, inadvertent remittances may occur either through direct remittance of tainted funds or accidental use of credit cards being paid from unremitted income and gains. The UK tax advisor may have failed to ask the right questions, leading to incorrect assumptions.

When an error has occurred, can it be said that the client has taken reasonable care by having relied on a third party? HMRC guidance says: ‘A person cannot simply appoint an agent and deny responsibility for their tax affairs. The person still has a duty to take reasonable care, within their ability and competence, to make sure that

what they are signing for is correct.' This point has not been tested before the tribunals, but clearly HMRC would not agree with complete reliance on others.

There is also a difference between HMRC's general guidance on reasonable care, and the Requirement to Correct guidance. This is because the law in this area specifically sets out circumstances which do not amount to a reasonable excuse. The law (and thus HMRC's guidance) states that reliance on any other person to do anything cannot be a reasonable excuse 'unless you took reasonable care to avoid the failure'.
HMRC's guidance states that it would treat each case on its own merits and take into account the experience, ability and background of the individual. In practice, we have rarely found this to be HMRC's approach.

Reasonable excuse and care: court interpretation

In some cases, HMRC's approach may appear to judge a taxpayer's actions based on how they perceive or expect an ordinary person would have acted. Factors such as age, background and proficiency appear to play very little importance.

In the case of Perrin v HMRC [2018] UKUT 156, HMRC contended that an 'unexpected or unusual event' is required before there can be a reasonable excuse. However, the Upper Tribunal judgment said: 'It is regrettably still the case that HMRC sometimes continues to argue that the law requires any reasonable excuse to be based on some "unforeseeable or inescapable" event... It is quite clear that the concept of "reasonable excuse" is far wider than those remarks implied might be the case.'

The Upper Tribunal established principles to determine whether a taxpayer has a reasonable excuse:

1. Establish the facts that the taxpayer asserts give rise to a reasonable excuse.
2. Decide which of those facts are proven.
3. Decide whether, viewed objectively, those proven facts do indeed amount to an objectively reasonable excuse for the default and the time when that objectively reasonable excuse ceased. In doing so, it should consider the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times. It might assist the FTT, in this context, to ask itself the question: 'Was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?'

4. Having decided when any reasonable excuse ceased, decide whether the taxpayer remedied the failure without unreasonable delay after that time (unless, exceptionally, the failure was remedied before the reasonable excuse ceased).

Summary

Each case should be reviewed on its own merits. Fundamentally, HMRC should be requested to put itself in the taxpayer’s shoes to assess reasonable excuse. Where appropriate, consideration should be given to an independent review and alternative dispute resolution. In a few cases, taxpayers may need to take their dispute to the tribunal.