

Reasonable excuse

When is reasonable excuse relevant?

Broadly speaking “reasonable excuse” is a potential defence where a taxpayer fails to do something or does something later than they should have done it. Typically this will usually be either filing a return late or paying tax late. Alternatively it might involve failure to notify chargeability or a breach of the information and inspection rules. As the result of doing any of these is normally a penalty of some sort, “reasonable excuse” is normally a defence against a penalty determination or a surcharge.

What is the statutory basis for reasonable excuse?

Section 118(2) Taxes Management Act 1970 (TMA) says:

“For the purpose of this Act, a person shall be deemed not to have failed to do anything required to be done within a limited time if he did it within such further time, if any, as the Board or the tribunal or officer concerned may have allowed; and where a person had a reasonable excuse for not doing anything required to be done he shall be deemed not to have failed to do it unless the excuse ceased and, after the excuse ceased, he shall be deemed not to have failed to do it if he did it without reasonable delay after the excuse had ceased.”

So this section will cover personal, partnership and trustee returns, corporation tax returns and a variety of sundry returns of various kinds. It also covers payment of income tax, capital gains tax and corporation tax. It does not cover VAT.

In addition to this section, the defence of reasonable excuse is sometimes contained in the detailed sections dealing with particular penalties and surcharges. For example:

1. Self-assessment surcharges occur where tax is paid more than 28 days late (S59C TMA). Reasonable excuse is the only grounds on which a Tribunal on appeal can set aside the surcharge (S59C(9)(a) TMA) but inability to pay cannot of itself constitute a reasonable excuse (S59C(10)).
2. S59(7) VAT Act 1994 does the same for VAT. A similar caveat to the income tax surcharge rules applies where you don't have the money to pay on time as S71 VATA says that an insufficiency of

funds is not a reasonable excuse (nor is reliance on another person). There is, though, a defence where the return/payment was sent in good time and would have been expected to get there on time S59(7)(a) VATA.

3. Information and inspection powers. This is covered by Schedule 36 FA 2008 and Para 45 includes a reasonable excuse defence but there are caveats about insufficiency of funds and reliance on 3rd parties.
4. Failure to notify. Schedule 41 FA 2008 brings together provisions for failure to notify across all the main taxes including VAT and also a long list of esoteric matters such as remote gaming duty (whatever that is). Paragraph 20 also includes a reasonable excuse defence with caveats identical to the ones in Para 45 above.
5. Failure to make returns. Schedule 55 FA 2009 brings together provisions across most taxes, including CIS returns, but excluding VAT which is dealt with under the specific VAT default surcharge regime. Again, the reasonable excuse provisions are at Para 23 and are identical to the ones in Para 45 above.
6. Late payment of tax. Schedule 56 FA 2009 pulls all the provisions together across most taxes, including CIS payments (but again excluding VAT for the same reasons as above.) The reasonable excuse provisions are at para 16 and again contain the same caveats as Para 45 above.

As a result of the wholesale reform of the penalty regime in 3-6 above, the effect of S118(2) TMA is arguably reduced. It still applies where the taxpayer has been allowed extra time to do something (by the Board for example) but the second part of the section, though the wording is not identical to the standard wording in the reasonable excuse provisions 3-6 above, has the same effect. That is to say, you have to have a reasonable excuse throughout the whole of the period of default and remedy the failure without unreasonable delay once the excuse has ceased.

It is still relevant in respect of surcharges as S59C(9)(a) provides that the reasonable excuse must exist throughout the period of default. There is no leeway so paying tax a day or two after the excuse had ceased would not avoid a surcharge without S118(2). It will also apply to any penalties not falling within 3-6 above, though I can't think of any at the moment.

VAT is interesting. S118 does not apply to VAT and the reasonable excuse rules in S59(7) VATA 1994 are therefore self-contained. What S59 actually says is:

If a person satisfies the Commissioners....that:

- (a) the return...was despatched...in such a manner that it was reasonable to expect that it would be received....within the appropriate time limit, or
- (b) there is a reasonable excuse for the return...not having been so despatched,

he shall not be liable to the surcharge.

To take an example, if a VAT return is due on 31 December 2012 and is received on 31 March 2013 a surcharge arises. If the taxpayer had been called away on 30 December 2012 for a family emergency such as a bereavement or serious illness and returned on 7 January 2013 he doesn't have a reasonable excuse after 7 January 2013 but one only has to look at whether there was a reasonable excuse for the return not getting there *on time* (my italics). There was in this case so no surcharge applies.

Does it apply to interest?

Yes and no. On the one hand, S118 seems wide enough to encompass interest as it would deem tax to have been paid on time. However, unlike penalties, there is no appeal process for interest so there is no formal mechanism for disputing interest charges (e.g. by appeal to the Tribunal). Indeed HMRC manual DMBM404020 specifically says (in the context of giving up interest where there has been HMRC delay) "Unlike late filing and late payment penalties, reasonable excuse is not a consideration when dealing with interest objections". This does not seem to be correct as S118 would deem the tax to have been paid on the due date. In practice, the only route for disputing interest where reasonable excuse is successfully claimed against a penalty determination would be to defend a claim in the Magistrates or County Court when HMRC take legal action to recover the debt that they think is still due. The defence would be that no debt exists because of S118.

What is a reasonable excuse?

It is important to understand that "reasonable" does not mean "understandable". In other words you might be able to see how something got delayed and might well be able to imagine yourself doing the same in other circumstances.

Nor does it necessarily mean what HMRC think it means. Their website states:

“Generally, a 'reasonable excuse' is when some unforeseeable or unusual event beyond your control has prevented you from filing your return on time.”

This is not the full story and we need to look at the case law for full guidance. Unfortunately not all of it is fully consistent with other decided cases. We also need to look at the specific statutory provisions (as set out above) as these sometimes modify the basic position.

There are some principles which are fairly clear from decided cases (mostly Tribunal cases admittedly):

Honest and genuine belief

In Holly Chichester TC/2011/07605 the Tribunal followed the line of reasoning that such a belief can constitute a reasonable excuse, at least until the person becomes aware that it is incorrect. The judge added that this belief was a subjective not objective test so one was to look at the state of mind of that person. The Tribunal judge referred to two cases (which he had also presided in) - HMD Response International and Purveur, both in 2011. However, in Intelligent Management UK Ltd (later in 2011) this view was slightly diluted by a different tribunal judge who expressed the view that the honestly held belief could not be irrational and unreasonable and there must be a reasonable basis for the honest and genuine belief. The latter view seems more logical in the context of what is a reasonable excuse.

The case of Anthony Leachman TC 01125 also supports the idea that if A thinks that B is filing the return and vice versa, that too can be a reasonable excuse if the belief is genuinely held. This may be stretching the doctrine to its limits and there are practical and evidential issues which might make this line of defence fairly rare.

Intent

In Mark Kelly TC 01439 the judge criticized HMRC's interpretation of reasonable excuse and commented:

“The HMRC position on what can amount to a reasonable excuse is formulaic and narrow. The expression “reasonable excuse” should have its ordinary meaning. It should be sufficient that the Appellant “seriously intended to honour his tax liabilities in all of the circumstances in the case”

So it looks as though serious intent will work if it can be proved, presumably on the basis that if there was such a serious intent and the circumstances supported it, it would be difficult to argue unreasonable behaviour.

Insufficiency of funds

As mentioned above, insufficiency of funds is not a reasonable excuse. However this apparently absolute bar on the excuse has been significantly tempered by the Steptoe case in the Court of Appeal. One of the judges said that:

“absent some ‘unforeseeable or inescapable’ event, cash flow problems are, in my opinion, barred from constituting a ‘reasonable excuse’

and this “unforeseeable or inescapable” point is the most commonly voiced reason. However, the majority of the judges actually formulated the test as follows:

“If the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds.”

In other words it does have to be inescapable but not necessarily unforeseeable (in the Steptoe case the customer was a consistently late payer).

Reliance on 3rd parties

Firstly, for VAT it cannot be a reasonable excuse as S71(1)(b) VATA says so. Having said that, one wonders whether there is scope for looking beyond the reliance point in the same way the court looked beyond the (apparently) absolute bar in relation to insufficiency of funds. For example the taxpayer might for whatever reason have had no option but to rely on a 3rd party (perhaps because they are illiterate, innumerate, severely dyslexic or phobic). If they acted reasonably and with serious intent to file it is difficult to see a Tribunal not letting them off if the agent got something wrong. Maybe the argument would be on the “events beyond the taxpayer’s control” theme rather than the reliance on a 3rd

party.

Turning to direct tax and CIS, 3rd party reliance is resisted by HMRC as part of a reasonable excuse argument for obvious reasons. If HMRC let the taxpayer off, they usually have no recourse to the 3rd party as there is no contractual link and no direct duty of care. Also, the position will often be unclear as to who has failed to do what.

There is a question of who is a 3rd party and also whether the default was caused by reliance. For example a key employee going sick shortly before a filing deadline might well come within the “events outside the taxpayer’s control” principle. Arguably they aren’t a third party if they are an employee. If a self-employed bookkeeper destroys the taxpayer’s records, the defence would not be that the taxpayer relied on the 3rd party to do the job (which would certainly fail for VAT purposes) but would again be on the “events outside the taxpayer’s control” principle. The cause of the default was the destruction of the books and records not the reliance on the 3rd party.

There is some limited scope for 3rd party reliance in specific circumstances. Here are some cases where reliance on a 3rd party was accepted as reasonable:

Mrs AM Rowland SPC 00548. Use of reputable accountants to deal with a complex area of law was regarded as a reasonable and sensible course of action in the circumstances.

Providence Health Consultants Ltd TC02988. Using a person who was purportedly a chartered Accountant but turned out not to be was considered reasonable when the P35 was not filed on time.

Stephen Rich TC01380. Failure of the accountants to notify HMRC of chargeability to tax after being requested to do so by the taxpayer meant he had a reasonable excuse for not filing and paying tax on time.

JR Hanson TC02000. A taxpayer relied on his accountant to complete a return with some complicated entries for loan-notes and rollover relief. They got it wrong but there was no evidence of carelessness on the part of the taxpayer. This was actually a case about penalties for incorrect returns so was concerned with carelessness.

Elizabeth Mariner TC03039. In this case (negligence again not late filing/payment) the judge distinguished between an adviser acting as a

professional person rather than as a functionary for filing and other administrative purposes. In the case of the former, it could not be unreasonable to rely on a professional person to give advice on technical points beyond the ken of the taxpayer.

On the HMRC side, a couple of cases are often cited by them:

Wald TC01052. This case seems to question whether a taxpayer can ever rely on an agent:

“The obligation to file a correct tax return is on the taxpayer, and the taxpayer cannot transfer that obligation. If the Appellant relies on an accountant to prepare and file a tax return on his behalf, then the Appellant will be responsible if errors in the tax return are due to negligence by the accountant acting on his behalf (compare *Smith v HMRC* [2010] UKFTT 92 (TC) at [25]-[29] and [107]; *Employee v HMRC* [2008] STC (SCD) 688, SpC 673). If there has been negligence on the part of an accountant, it may be that the taxpayer may have some recourse against the accountant. However, that does not normally affect the liability of the taxpayer to a penalty for filing an incorrect return.”

However in this case the omitted tax return entry (i.e. another negligence case) was for relocation expenses so was not a complex tax issue of which the taxpayer would have been ignorant.

Stratton TC02967. An agent claimed CGT treatment for shares which were subject to income tax. HMRC were successful partly because the Appellant received quite a lot of information about the correct treatment of the shares from the company but did not follow it up.

It is difficult to pull all these cases together in a cohesive way. Firstly it seems that it's easier to use 3rd party reliance where the taxpayer is completely out of his depth because of the complexity of the circumstances (e.g. a tax avoidance scheme). It is less easy where the matter is routine and is something which the taxpayer could maybe have attempted themselves. The morality of this is questionable to say the least. Secondly, if the taxpayer is aware of some uncertainty, he should make further enquiries to assure himself of the competence of the adviser and the advice given (but *Providence Health* above seems to indicate this may not be necessary). The taxpayer must still be diligent in checking, as far as he can, the work done by the 3rd party.

Reliance on HMRC

There are few if any cases on this. In principle it is reasonable to rely on HMRC advice though not necessarily to rely on HMRC to do something (such as sending reminders). There are also a number of matters where the onus is firmly on the taxpayer to take the lead, such as asking for a SA return if one is required. The practical problem is often evidential i.e. proving that HMRC did advise a particular course of action or how a transaction should be treated. HMRC do keep records of conversations but not for generic calls to helplines. So there may be no record of a conversation having taken place or its content. Even if there is, there is the problem of proving that HMRC were given the full circumstances leading to the advice given.

Personal circumstances

I haven't come across any cases in this area, maybe because they are so fact-specific. However it's clear that things such as illness, bereavement and the like will normally be looked on sympathetically as will natural disasters (fire/flood/wind). The difficult question in practice is whether that excuse exists for the whole of the relevant time.

What if any is the link with the penalty regime in Schedule 24 FA 2007?

If the error is by the taxpayer, he is liable to a penalty if he has been (at least) careless. So what does careless mean? Para 3(1) says that carelessness is failure to take reasonable care.

If we are talking about reliance on a 3rd party, Para 18(3) the taxpayer is not liable for an agent's error if he took reasonable care to avoid the inaccuracy.

So either way we are talking about taking reasonable care, which sounds very like reasonable excuse assuming reasonable has the same meaning in both contexts.

However, according to the judge in JR Hanson TC02000 there isn't any link between the two:

"I do not consider that the meaning of reasonable excuse in the context of a failure to make a return or make a payment of tax gives any real assistance in construing Para 18 Schedule 24 Finance Act 2007. Paragraph 18 is specifically dealing with the reasonableness of reliance

on a third party agent whose act or omission causes an inaccuracy in a return.”

Having said that, the word “reasonable” then makes an appearance later on in the judgement where the Upper tribunal case of *Colin Moore* UKUT 2011 239:

“The test to be applied, in my view, is to consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done.”

This test seems wide enough to encompass actions which might constitute a reasonable excuse for (say) late filing as well as actions leading to an incorrect return.

Summary

- the term “reasonable excuse” should take its ordinary meaning;
- an honest and genuine belief can be a reasonable excuse as long as it is not irrational or unreasonable;
- Serious intent to honour one’s tax obligations can be a reasonable excuse;
- Insufficiency of funds is generally not a reasonable excuse unless it is attributable to events outside the person’s control. These events do not need to be either sudden or unforeseeable;
- Although insufficiency of funds seems to be excluded absolutely as a reasonable excuse, case law (*Steptoe et al*) has modified this so that the position is as above;
- Reliance on a 3rd party is not a reasonable excuse for VAT purposes (apparently under any circumstances);
- Other than VAT, reliance on a 3rd party can be. From the rather confusing case law in this area, it seems that outsourcing complicated tax issues and relying on the advice received may well constitute reasonable excuse but outsourcing routine matters will be more difficult. Also, the taxpayer retains an obligation to check figures as best they can and to be alert to and follow up on anything where they are aware that the position is unclear/complicated. The taxpayer must also exercise proper diligence with matters about which it would be reasonable for them to be familiar.
- Reliance on HMRC can be a reasonable excuse but there will often be evidential barriers to overcome in proving reliance;
- Personal circumstances such as illness or bereavement or natural

disasters would normally be considered favourably if the circumstances are sufficiently serious.

- The reasonable excuse must exist for the whole of the period of default (but maybe not for VAT default surcharge purposes).