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# **Guernsey STEP – topical tax issues in the world of HMRC investigations**

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# Synopsis

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- **Reasonable excuse**
  - Why it's super important
  - What HMRC thinks it is vs what it really is
  - Examples/cases
- **Making a disclosure**
  - Choosing different routes
- **Current HMRC activity**
  - One to many 'certificate' letters
  - Financial Institution Notices
  - A brief word on furlough fraud

# Reasonable excuse - why it's currently important

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- In a nutshell, reasonable excuse is anything not done that the tax rules require you to do
- Such as failing to file a return or pay tax on time
- Potentially a double – and expensive - hit for offshore errors:
  - Failure to notify in the first place = 20 years potentially opened up
  - Failure to correct  **massive** penalties not based on behaviour (NB: up to 2015/16 only)
    - Minimum 100%
    - Minimum 150% if prompted, eg by a certificate letter (see later)
    - Loads more to come (several million accounts notified)
- Hence the importance of establishing a reasonable excuse to significantly reduce the number of years, from 20 to 4, and the penalty, potentially to nil or to a 'normal' penalty

# Reasonable Excuse – what the law says

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- **Section 118(2) TMA 1970**

*...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 if he did it without unreasonable delay after the excuse had ceased*

- Legislation does not define what a reasonable excuse is, just what happens if you have one. So what does this mean?

# HMRC's (unreasonable) view

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- **Enquiry Manual**

*HMRC consider 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*

- Stops?
- Reasonable care?
- Wanted?

# HMRC's (unreasonable) view

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- Ignorance of the law is not a reasonable excuse
- It is unlikely that illness, absence or family problems would persist at such a level, throughout the period during which chargeability could be notified, as to constitute a reasonable excuse for an extended period.
- Even if the taxpayer's difficulties were at their worst at the crucial time at the end of the period, they should still be able to find time to comply with their statutory duties within a reasonable time thereafter.
- You should not accept as a reasonable excuse
  - failure by the agent
  - delays in the post, unless there was an exceptional event disrupting the postal service

# HMRC's (unreasonable) view

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**The following will not be accepted as a reasonable excuse:**

- you relied on someone else to send your return and they did not
- you made a mistake on your tax return

# HMRC's (unreasonable) view

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## What may count as a reasonable excuse

- your partner or another close relative died shortly before the deadline
- you had an unexpected stay in hospital that prevented you from dealing with your tax affairs
- you had a serious or life-threatening illness
- a fire, flood or theft prevented you from completing your tax return
- postal delays that you could not have predicted
- delays related to a disability you have

# HMRC's (more sensible) view

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- 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.
- An unexpected combination of events may together be a reasonable excuse.
- It is not possible to give a comprehensive list of what might be a reasonable excuse as each case will depend on the specific circumstances.

# Reasonable excuse – the reality

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- It does not have to be extreme, only has to be ‘reasonable’
- Not exceptional or outside taxpayer’s control
- *Anthony Leachman (TCO1125):*
- *HMRC argues, wrongly, that before a person can establish a "reasonable excuse" it must be established that there are exceptional circumstances or some exceptional event giving rise to the default. That is not what Parliament has laid down. Parliament has used the ordinary English words "reasonable excuse" which are in everyday use and must be given their normal and natural meaning.*
- HMRC ignores this and still relies on the minority ruling in *Steptoe from 1996*

# The Perrin case

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- ***Perrin [2018] UKUT 156***
- The most important recent reasonable excuse case around
- Not complicated subject matter – penalties for failing to file a tax return on time
- It is Upper Tier, hence precedent

# Perrin – brief summary of the facts

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- Attempted to file 2010/11 pre 31 Jan 2012 deadline
- Believed she had done so but had failed to complete the final step
- Penalties issued and appealed
- June 2012 tried to file again
- Success – but had filed a 2011/12 form, the wrong document
- HMRC wrote in July and August 2012
- Taxpayer called HMRC September 2012 and correctly filed the same day
- Penalties still in play hence appeal
- Taxpayer's genuine and honest belief that return had been filed = reasonable excuse

# Perrin - decision

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- The excuse in question must be objectively reasonable
- Correct approach is:
  - Establish the facts
  - Decide if those facts, *viewed objectively*, = a reasonable excuse for the default
  - Decide when the reasonable excuse ceased
  - Take into account circumstances, experience and attributes of the taxpayer
  - Decide if the taxpayer remedied the failure quickly enough
- Ignorance can be a reasonable excuse – matter of judgement, objectively reasonable for that particular taxpayer?
- Overall:
  - Excuse has to be genuine
  - And objectively reasonable

# Perrin – the correct test for reasonable excuse

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- Para 69 – the burden of proof that a penalty is due in the first place is on HMRC
- Para 70 – do the facts, viewed objectively, amount to a reasonable excuse (assuming HMRC has demonstrated that a penalty is due in the first place).
- The burden of proof that there is a reasonable excuse for the default is on the taxpayer
- Para 71 – as well as the situation generally, the experience, knowledge and other attributes of the particular taxpayer should be taken into account.

# Perrin – the correct test for reasonable excuse

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Paras 72 – 74

- If the taxpayer relies on a state of mind, eg '*I thought I had filed the required return*' or '*I did not believe it was necessary to file a return in these circumstances*' the tribunal must decide whether that state of mind actually existed.
- Common sense approach to inherent probability that this is correct
- The tribunal must then assess whether the facts (including state of mind) are sufficient to amount to a reasonable excuse
- **This must be judged objectively, the taxpayer's belief alone is not sufficient**

# Perrin – the correct test for reasonable excuse

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- *‘I genuinely and honestly believed that I had submitted a return’*
- *The FTT [as the fact finding tribunal] may accept that the taxpayer did indeed genuinely and honestly hold the belief that he/she asserts; however that fact on its own is not enough. The FTT must still reach a decision as to whether that belief, in all the circumstances, was enough to amount to a reasonable excuse.*
- *So a taxpayer who was well used to filing annual self-assessment returns but was told by a friend one year in the pub that the annual filing requirement had been abolished might persuade a tribunal that he honestly and genuinely believed he was not required to file a return, but he would be unlikely to persuade it that the belief was objectively a reasonable one which could give rise to a reasonable excuse.*

# Perrin – final point

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- Despite HMRC's view, ignorance of the law can be a reasonable excuse
- Para 82:
  - *'Ignorance of the law is no excuse'...has been given as a reason why the defence of reasonable excuse cannot be available...we see no basis for this argument.*
- Yet HMRC continues to ignore this:
- ***Leigh Jacques (TC07793) – July 2020***
- *I am also critical that the extract from Perrin which they [HMRC] include in their statement of case does not include the crucial paragraph [82] which deals with the principle that in certain circumstances ignorance of the law can comprise a reasonable excuse. If HMRC are going to cite Perrin and include extracts from that case then it is only fair that they include paragraph [82].*

# Reasonable Excuse

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- Two limbs:
- Reasonable excuse for failing to do something

AND

- Rectifying that without unreasonable delay

# Perrin – the sting in the tail

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- Remember that second limb of s118(2):  
*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 if he did it **without unreasonable delay after the excuse had ceased***
- Reasonable excuse for failing to do something AND rectifying that without unreasonable delay
- Mrs Perrin took too long
  - In May 2012 HMRC wrote and told Ms Perrin that there was another step to follow to complete the filing process.
  - Filing the correct return (not the 2011/12 one) in June would have been fine. HMRC told her of the error in July 2012 but she still took until 20 September 2012 to file correctly

# War Stories – The B family

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- Mr B had opened bank accounts in New Zealand for his 3 grown up, UK resident, children and deposited significant capital in each.
- The capital was earning interest over a seven year investment period, but the interest was credited to each account on an annual basis. A small amount of tax was withheld.
- No party had ever declared the income in the UK or elsewhere and so there was a FTC.
- Mr B had an honest belief that the interest was not taxable until the 7 year investment period had ended and so he had not told his children that they had a liability to UK tax.
- The (adult) children in 'receipt' of the income did not know it was taxable in the UK.
- HMRC went for 150% FTC penalties

# War Stories – K Settlements

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- Connected non-UK Trusts, settled more than 25 years ago.
- At the time of settlement the Trust Service Provider recorded the settlor's domicile as non-UK - incorrect, the settlor was deemed UK-domiciled at the date of settlement.
- There was therefore exposure to UK IHT on entry and at 10 year anniversaries but no returns were filed and no IHT paid.
- The TSP reviewed a large volume of cases ahead of the RTC deadline and the exposure to UK tax was missed on review until after the RTC deadline.
- HMRC wanted a £250,000 FTC penalty

# War Stories – K Settlements

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- **There were extenuating circumstances:**

- An esoteric change in law (FA 2006 Sch 20, Para 30) changed the nature of the trust;
- BREXIT induced delay of FA (no.2) 2017 gave little time before 30 September 2018;
- TRS came in on 26 June 2017 and took resource away from reviews;
- The trustees reviewed 2,000 structures and missed this issue in isolation;
- Reputation of trustees who always corrected (very small number of) problems.

- **HMRC got it wrong in parts of their argument:**

- Expected reviews of settlor's domicile at 10<sup>th</sup> anniversaries, but this is not relevant;
- IHT not included in RTC legislation.

## **Intention of parliament**

- RTC was to catch 'serial offenders' not usually compliant TSPs who made errors.

# HMRC's current position

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- Review of post 2012 powers ongoing
- This has highlighted RTC – by far the most commented on
- FTC = penalties unless reasonable excuse
- Experience of RTC to date is no change in HMRC approach, change is needed

# And finally...more Perrin

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## Para 83:

- It is regrettably still the case that HMRC sometimes continue to argue that the law requires some... 'unforeseeable or inescapable' event
- Where HMRC base their argument on this unsustainable position, the FTT may well consider it appropriate...to award costs against HMRC
- Similar observations apply to the HMRC 'mantra' to the effect that an 'unexpected or unusual event' is required...the statutory phrase is 'reasonable excuse'...the addition or substitution of other words...should be avoided



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# [Some of the] ways to make a disclosure – WDF/CDF

# What is the Worldwide Disclosure Facility?

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- A means for an individual, business, company or trust to disclose overseas income and undeclared overseas assets or interests;
- Applies to UK resident or non residents with UK tax liabilities from overseas assets;
- Need to disclose any onshore as well as offshore tax liabilities;
- Digital disclosure service;
- Can disclose Income Tax, Capital Gains Tax, IHT but not VAT;
- Initial registration
  - easy
  - personal details (name/address/DOB/NI number etc)
- HMRC respond and provide ref number
- LPC is similar (for individuals) and therefore useful if landlord has undeclared rental income

# Advantages

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- Online forms are suitable for simple disclosures (eg small amounts of bank interest etc);
- Registration quick and easy;
- Encourages fast track disclosures, if only agreement letters were as streamlined;
- It still exists as a facility where other facilities have been closed;
- Can disclose onshore as well as offshore tax liabilities.

# Disadvantages

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- Mechanical
- 90 days is not long enough – could lead to incorrect disclosures
- Forms do not allow for explanations required in complex cases;
- Will not 'compute' (accept) nil penalties
- Backlog of cases
- No means to seek closure where there is extensive delay
- Initially no officer to speak with only a call centre where your update request is logged
- Disclosures where overseas assets exceed £1m are funnelled for 'special attention' – FIS might take up review??
- Risky for unrepresented taxpayers who lack specialist knowledge
- Not everyone can pay dues within 90 days
- **NO CARROTS SUCH AS IMMUNITY FROM PROSECUTION IF NEEDED**

# Contractual Disclosure Facility – CDF/COP 9

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- Overwhelming number of disclosure cases fall within ignorance/technical/careless categories.
- But if there has been deliberate behaviour, the CDF is an excellent mechanism and should be grasped with both hands
- Clients can volunteer for the CDF, no need to wait for HMRC to offer it
- Deliberate behaviour simply means an intention to pay less tax than the law provides

# What it is

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- A contractual arrangement:
  - The taxpayer's side is that s/he undertakes to provide a full, detailed disclosure of all irregularities.
  - HMRC's side is that, in return, there is a guarantee that HMRC will not pursue a criminal investigation and potential prosecution
  - Once settled (by contract settlement) the past is closed for good
- Taxpayer must treat it seriously
  - Anything less than a full disclosure, all bets are off
  - The disclosure must be very detailed and covers up to 20 years
  - Lots of data to analyse in a short period

# Advantages

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- This is a Government department accusing a citizen of fraud without having to prove it and then asking for a confession. But:
- There is no criminal investigation, it is kept out of the courts and out of the public eye.
- It is a civil procedure so the taxpayer will have no criminal record.
- Professional standing can be preserved, for example if the taxpayer is in a profession governed by a regulatory body.
- No large scale tax fraud or minimum amount of tax is needed, it can be used for simple cases such as a single entry being deliberately omitted from a tax return.
- A full and cooperative disclosure should lead to maximum penalty mitigation which means that the taxpayer will not be 'named and shamed' on HMRC's website.
- It will be handled by an experienced inspector, who has usually 'been round the block' and is commercially aware, not a local enquiry officer
- HMRC will take a step back and let the advisor/client get on with it, they will not be issuing information notices and asking lots of questions

# Other things to consider

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- It should not be used as a convenience, eg to avoid HMRC running the investigation, only advisable where there was a deliberate intention to evade tax.
- There are higher penalties for deliberate, rather than merely careless, behaviour.
- You may have been acting under the advice of a qualified professional (accountant, IFA, solicitor or barrister). Even if their advice was wrong, is it fraud?
- If you work in a regulated sector you will not want to be 'named and shamed' as a tax evader, since this could impact on your career.
- If you are a professional, admitting to tax fraud may put you under an obligation to report yourself to a professional body, which may lead to other punitive sanctions.
- Innocent participation in a tax scheme does not equate to tax fraud.

# Other things to consider

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- Your business or your company may have been the victims of a fraud perpetrated by a third party of which you are unaware.
- Information may have been disclosed to HMRC maliciously by third parties which is capable of explanation.
- Do not act on what a non-specialist adviser says, eg that there must be truth in an allegation 'otherwise why would HMRC have accused you'.
- Costs of a CDF will be high, but not as high as the tax/interest/penalties if HMRC is given free rein or the costs of appealing assessments and penalties imposed by HMRC, as well as the 'aggravation' saved.
- Risk of 'naming and shaming' - personal and business reputation? Commit wholeheartedly to the process to get maximum penalty mitigation



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# Other topical issues

# Financial Institution Notices (FINs)

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- Draft legislation for next year's FA
- FINs will enable HMRC to request information from a Financial Institution (FI) about a taxpayer without the need to seek approval and will apply to FI's as defined under CRS.
- Currently HMRC need agreement of the taxpayer or approval from the Tribunal
- No right of appeal
- Hence safeguards at either end taken out –no prior approval beforehand, no right of appeal once issued
- This is the sort of data HMRC relishes; giving HMRC unfettered access to personal financial matters will lead a lot of new activity and 'fishing'.

# Financial Institution Notices

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- HMRC in the FT 19/9/20:
- *“The new power will contain numerous safeguards...and the power can only be used in specific circumstances where the information is reasonably required [to check] the taxpayer’s tax position”.*
- That is not an entirely correct picture in this respect, a more accurate quote being that *“the power can only be used in specific circumstances where a single officer of HMRC decides that the information is reasonably required to check the taxpayer’s tax position”.*
- Hence no oversight of the validity of the decision to issue a FIN in the first place and no right to examine and check that validity after it has been issued.
- One party – not HMRC as a body, but an individual officer of HMRC - has 100% of the power to decide whether a request is reasonable or not, not much of a safeguard.
- As I noted in the same FT article, *“The tax tribunal is a crucial safeguard to ensure proper scrutiny...it is worrying HMRC might bypass this system...in some instances without the taxpayer knowing”.*
- If HMRC has confidence in its officers’ decisions it should have no objection to appropriate oversight of them by the independent tax tribunal.

# One to many letters

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- Been around for a while now as a result of CRS data received by HMRC
- Usually with a certificate attached. Do not sign it
- New batch from August 2020 with key difference that:

**HMRC will have checked the CRS data against the tax return submitted**

- May well be reasons for apparent missing data, eg
  - Timing difference (CRS being for calendar years)
  - Errors such as including foreign income in the UK rather than the foreign boxes
- If client receives one, refer to tax advisor rather than advise on it yourself – JC's IoM example

# Furlough fraud/errors

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- HMRC believes up to £3.5bn of covid-related payments claimed fraudulently or paid out in error
- HMRC has said that 8,000 calls have been received by its fraud telephone hotline and that HMRC is looking into 27,000 high risk cases.
- These are all massive numbers in the context of HMRC's normal investigation activity.
- Three arrests already made
- There is a new 100% tax to achieve this with a potential penalty of up to 100% of the tax on top.

# Furlough fraud/errors

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- Finance Act 2020 has created new rules which cover all covid-related payments
- There is a brand new income tax
- But it applies to corporates as well
- Tax rate of 100%, ie repay everything wrongly claimed
- Plus a penalty of up to another 100%
- Automatically deemed to be 'deliberate and concealed' which leads us back to where we started....
- **Reasonable excuse** (for failing to notify chargeability to the new tax)!

# Contact

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John Cassidy is one of our two Tax Resolutions partners in the Taxation Awards winning team and has 28 years' experience working in tax. John regularly writes and lectures on tax topics and has written copious amounts on tax investigation matters in the national and professional press and publications. He also lectures at tax conferences in the UK and overseas on investigations, HMRC's powers and taxpayer rights. John covers all aspects of tax resolutions including fraud, HMRC challenges under self-assessment, professional negligence cases concerning tax, disclosures to HMRC and expert witness work relating to tax matters. John is a Fellow of the ICAEW and a member of the Chartered Institute of Taxation as well as deputy chairman of the ICAEW Investigations & Compliance Committee and a member of the Management of Taxes Committee at the Chartered Institute of Taxation.



# Contact

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Hayley Ives is a Director in the award winning Tax Resolutions team. She joined the Tax Resolutions group in 2013 and has 14 years' experience working in tax.



Hayley deals with all aspects of tax resolutions including fraud investigations, HMRC challenges under self-assessment and voluntary disclosures to HMRC.

Hayley is a member of the Chartered Institute of Taxation, having specialised in taxation relating to individuals and trusts and estates / Inheritance Tax. She has written articles on tax resolutions matters that have been published in professional magazines such as *Taxation* and *Tax Adviser* and she helps the charity TaxAid with cases involving tax disputes.

Hayley is currently studying for the STEP Diploma in Tax and Estate Planning.