



# Guide to what is the meaning of the terms false and misleading statement, reasonable care, gross carelessness and intentional disregard and the penalties for making them.

## Introduction

This Guide explains the meaning of certain terms used in the tax law for which a person can be liable to a penalty under the Tax Administration Act 2022.

See PR 2024/2 *Meaning and Penalty relating to false and misleading statements, reasonable care, gross carelessness and intentional disregard* available on the IRD website, for more details on this topic.

The Guide gives the Commissioner's interpretation of what constitutes a false and misleading statement. The Guide also gives the Commissioner's interpretation of the concepts of reasonable care, gross carelessness and intentional disregard.

## False and misleading Statement

### ***What is a Statement?***

The Commissioner considers a statement is anything communicated to the Commissioner or to another person exercising powers or performing functions under a tax law, including a statement made to a tax officer in the course of her or his duties.

A statement may be made or given in writing, orally or in any other way, including electronically. Statements may be made in:

- correspondence;
- responses to requests for information;
- a notice of objection;
- a request for an amendment to an assessment;
- an answer to a questionnaire; or

- connection with an audit or investigation.

A statement will also include entering an amount or other information at a label on an application, approved form, certificate, declaration, notice, notification, return or other document prepared or given under a tax law.

A statement may be made where a person fails to include information in a document or approved form when there is a requirement to do so, this is considered a negative statement.

For example, that there was no liability or that an event did not occur. If no statement is made because of a failure to lodge an approved form (for example, an Income Tax return) the person is not liable for a penalty. However, the person may be liable to a penalty for gross carelessness for failing to provide a document necessary for determining a tax related liability.

**Gross carelessness** is more than a lack of attention or care. It is considered to be a conscious, voluntary act or omission in reckless disregard of a legal duty and the consequences to another party.

### **Is the statement false or misleading in a material particular?**

*Whether a statement is false is a question of fact.*

The Commissioner considers that a statement or omission is misleading if it is reasonably likely to mislead a person belonging to the class of persons to whom

it is directed. A penalty is only imposed if the statement is false or misleading in a material particular.

A statement is **misleading** if it creates a false impression, even if the statement is true. It may be false or misleading because of something contained in the statement, or because something is omitted from the statement. Even if it is factually true, it may be misleading because it is uninformative, unclear or deceptive.

A statement is **false** if it is contrary to fact or wrong irrespective of whether or not it was made with knowledge that it was false.

If a statement was correct at the time it was made but is subsequently made incorrect because of a retrospective amendment to the law, the statement is not later considered false or misleading. It is the nature of the statement at the time that it was made that is relevant.

No penalty is imposed where the person did not know (subjectively determined) and could not reasonably be expected to have known (objectively determined) that the statement or omission was false or misleading.

The Commissioner considers "**Reasonably be expected to know**" means whether a reasonable person, in the same circumstances as the person, would be likely to have knowledge of the truth in making the statement. In practice, this means that all actions leading up to making the statement should be taken into account, including record keeping, reporting and using a registered tax agent.

Whether a person could not reasonably be expected to have known is considered objectively. This means that the test is not whether the person could have been expected to have known, but rather whether they have in fact the knowledge.

Where a person makes a genuine effort to ensure that statements made to the Commissioner are correct, it is likely that the facts will show that they could not **reasonably be expected to have known that the statement or omission was false or misleading**.

The standard/level of knowledge in the circumstances of the person is not meant to be overly onerous. It does not mean that a person or their agent is required to demonstrate the highest possible level of knowledge. The standard is that of an everyday person in the circumstances of the particular person.

Determining what would amount to knowledge that the statement was false or misleading in making a statement in the circumstances of the person involves recognition of that person's:

- personal circumstances (such as age, health and background)
- level of knowledge, and/or
- understanding of the tax laws and attempt to do so.
- time in business
- the relative size of the shortfall compared to the person's tax liability;
- the type of the item reported and the relative size of the discrepancy between what was reported and what should have been reported;
- the complexity of the law and the transaction (the difficulty in interpreting complex legislation); and
- the difficulty and expense associated with taking action to reduce or eliminate the risk of making an error.

Consideration will be given not only to the nature of the shortfall but also to the relative size of the error arising from the statement. In other words, the bigger the shortfall, the

greater the likelihood that the person or his or her registered tax agent will be considered to have knowledge or reasonably expected to have that knowledge.

**Factors** indicating that a person is considered to have knowledge that the statement was false or misleading in making a statement or reasonably expected to have that knowledge include:

- taking an interpretative position with respect to an item that is frivolous or which lacks a rational basis;
- repeated errors where the person has been advised or is otherwise aware that mistakes have previously been made;
- an error which could have been avoided with relative ease, for example, systems failures the risk of which are foreseeable or for which the person has not established adequate safeguards and monitoring; and
- an error which results from the inadequate training of staff, in particular inexperienced or temporary staff.

An **error in adding, subtracting or transposing amounts** by a person may lead to the conclusion that the person is considered to have knowledge or reasonably expected to have that knowledge, but an error is not conclusive evidence of a person being considered to have knowledge or reasonably expected to have knowledge that the statement was false or misleading. An error made by a division of a business which leads to an error in the person's tax return may be considered to have knowledge or reasonably expected to have that knowledge, but this will depend on factors such as the circumstances in which the error was made and the procedures in place to prevent or detect such errors.

### **Example**

For an individual who prepares their own tax return, an earnest effort to follow instructions would usually be sufficient to pass the test. For example, if a taxpayer claimed a deduction for business expenses without having receipts, then this would indicate that the taxpayer had knowledge or reasonably expected to have knowledge that the statement was false or misleading in making the claim, since the Guides/ Instructions emphasise the requirement to keep records for business expenses.

### **Example**

For a person conducting a business, the "knowledge" or "reasonably expected to have that knowledge" test could be satisfied by the person putting in place an appropriate record keeping system and other procedures to ensure that the income and expenditure of the business are properly recorded and classified for tax purposes. The fact that an employee of the business makes an error would not necessarily mean that the person is subject to a penalty. For example, a penalty would not apply where the taxpayer can show that its procedures are designed to prevent such errors from occurring. What is reasonable will depend, among other things, on the nature and size of the business, and could include, for example, internal audits, sample checks of claims made, adequate training of accounting staff and instruction manuals for staff.

### **Example:**

A person that relies on a third party (excluding a registered tax agent) for advice of a fact that is relevant to the preparation of a return or other tax document will not be taken to have knowledge or reasonably expected to have knowledge that the statement was false or misleading unless the person knew or could reasonably be expected to know that the

information was wrong. For example, if a bank provides an interest statement and understates the amount of interest earned, as long as the person has no reason to believe that the statement is wrong, the person would not be liable for a penalty on the understatement.

The “knowledge” or “reasonably expected to have that knowledge” test that the statement was false or misleading focuses on the efforts taken by the person or their agent in resolving the tax treatment of a particular item. Full research may be enough to satisfy the requirement of no knowledge.

Employers are responsible for the acts of their employees provided the acts are within the acts authorised for that employee. Therefore, if an employee fails to meet the knowledge standard, the employer is liable for the failure. This is so whether the employer is a natural person or not. The only difference is that a non-natural employer must act through agents and employees as it is incapable of acting otherwise.

Using the services of a tax agent or tax adviser does not of itself mean that a person discharges the obligation to take reasonable care. It remains the person’s responsibility to properly record matters relating to their tax affairs and to bring all of the relevant facts to the attention of the agent in order to show reasonable care.

### **Example**

If a taxpayer fails to alert his accountant to the fact that he has derived a substantial amount of interest income and there is no acceptable explanation for the omission. The failure to disclose the interest income, the Commissioner considers is not reasonable. A person that engages a registered tax agent in these circumstances will be liable for an administrative penalty.

A person that uses an agent must provide the agent with all necessary information. To be taken to have passed the knowledge test, the person is expected to:

- properly record matters relating to tax affairs;
- provide honest, accurate and complete information in response to questions asked by the agent; and
- bring to the attention of the agent information the person could be reasonably expected to have known was relevant to the preparation of the income tax return, other return or other document.

A person's failure to meet these expectations would generally indicate knowledge on the person's part that the statement was false and misleading. If there is nothing to alert the agent, the agent will not be taken to have knowledge solely because of the person's failure to inform him/her. However, if the agent has reasonable grounds for suspecting that an inquiry could prompt further information, such as interest declared in the tax return of the previous year, that is necessary to complete an accurate return or document, the agent must take that step if the agent is to not have knowledge.

Reasonable care requires a taxpayer to make a reasonable attempt to comply with the provisions of the tax laws and regulations.

### **Who is liable for the penalty?**

Generally, where a statement is made by a person's authorised representative, the person will be liable for the penalty.

### **Example:**

A company will be liable for false or misleading statements made by an employee, public officer or director.

The onus is on the person and their agent to prove that they do not have or could reasonably be expected not to have that knowledge in making the false or misleading statement.

## **Reasonable Care**

### ***Meaning of reasonable care***

The expression 'reasonable care' is not a defined term and accordingly takes its ordinary meaning. A dictionary definition, defines 'care' as '... 3 serious attention; heed, caution, pains' and 'reasonable' as '3a within the limits of reason; not greatly less or more than might be expected'. Taking 'reasonable care', in the context of making a statement to the Commissioner or to a person, means giving appropriate serious attention to complying with the obligations imposed under a tax law.

The effort required is one appropriate with all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.

Since the test for establishing negligence is objective, the actual intention of the person said to be at fault is not relevant. The fact that the person has tried to act with reasonable care is not the test - what is relevant is whether, on an objective analysis (that is based on the facts), reasonable care has been shown.

The reasonable care test is not a question of whether the taxpayer actually predicted the impact of the act or failure to act, but whether a reasonable person in all the circumstances would have predicted it. The test does not depend on the actual intention of the taxpayer.

Another important aspect of the reasonable care test is that 'reasonable' does not mean the highest possible level of care or perfection.

### **Example:**

The reasonable care test requires a person to take the same care in fulfilling their tax obligations that could be expected of a reasonable ordinary person in their position. This means that even though the standard of care is measured objectively, it takes into account the circumstances of the taxpayer.

### **Example:**

The reasonable care test is not intended to be overly difficult for taxpayers. For most taxpayers, a serious effort to follow the Commissioner's Guides, Instructions and Public Rulings published on the website would usually be sufficient to pass the test.

There is no presumption that there is a failure to take reasonable care where there is a false or misleading statement. The evidence must support the conclusion that the standard of care shown has fallen short of what would be reasonably expected in the circumstances.

### **Example:**

The mere fact that a tax return includes a deduction which is not allowable is not of itself sufficient to expose the taxpayer to a penalty. Negligence, at least, must be established.

The appropriate standard of care required in making a statement is not unchallengeable, but takes account of the particular characteristics of the person concerned. Because there is no 'one size fits all' standard, the standard of care that is appropriate in a particular case necessarily takes account of:

- personal circumstances (such as age, health, and background);
- level of knowledge, education, experience and skill; and
- the class of person concerned.

**Example:**

A person that conducts a business and has onerous tax obligations arising from complex transactions would be expected to implement appropriate record keeping systems and other procedures to ensure they comply with their tax obligations understanding of the tax laws.

**Personal Circumstances**

Personal circumstances have the potential to compromise a person's capacity to comply with their tax obligations.

**Example:**

Age, mental health or physical incapacity may adversely affect the level of care and attention that can reasonably be expected in the circumstances.

**Knowledge, education, experience and skill**

Other personal attributes such as knowledge, education, experience and skill may also have an impact on the level of care that is reasonable when making statements to the Commissioner. The standard of care required is appropriate with a reasonable person with the same background as the person making the statement.

**Standard applicable to a person with expert tax knowledge**

A professional person with specialist tax knowledge will be subject to a higher standard of care that reflects the level of knowledge and experience a reasonable person in their circumstances will possess.

**Example:**

Where a taxpayer's agent requests an amended assessment on the basis that a lump sum payment on termination of employment was a bona fide redundancy payment and exempt from tax, tax agent should be expected to know or, at least find

out, about the possible treatment of the lump sum payment.

**New entrants to tax system**

The objective standard of reasonableness that applies is lower for a new entrant to the tax system who has little tax knowledge or experience in interacting with the tax system than a person who has more knowledge or experience. This ensures that a person's behaviour is only penalised if they fail to measure up to the standard of a reasonable person with the same level of knowledge and experience. Each situation will involve a unique mix of circumstances that requires an enquiry about whether reasonable care is shown or is lacking.

**Example**

For business persons, reasonable care requires the putting into place of an appropriate record-keeping system and other procedures to ensure that the income and expenditure of the business is properly recorded and classified for tax purposes.

The following practices are some examples of appropriate procedures:

- regular internal audits;
- sample checking;
- providing adequate staff training; and
- preparing instruction manuals for staff.

**Understanding of tax laws**

In determining the standard of care that is reasonable and appropriate in the circumstances, factors such as the complexity of the law and whether the relevant law involves new measures are also relevant. These factors have the potential to affect a person's capacity to understand their entitlements or obligations under the law.

**Example:**

If a person is uncertain about the correct tax treatment of an item, reasonable care requires the person to make appropriate enquiries to arrive at the correct taxation treatment. Such steps include contacting Inland Revenue, referring to an Inland Revenue publication or other authoritative statement, or seeking advice from a tax agent.

In the context of determining the value of a taxable importation for Goods Tax purposes, it may be appropriate to obtain an expert valuation or seek advice from Solomon Islands Customs Service in order to demonstrate reasonable care.

**Applying for a private ruling**

Although a person may choose to obtain a private ruling from Inland Revenue on a question of interpretation, failing to do so does not necessarily lead to a failure to take reasonable care.

**Example:**

If the taxpayer adopts an interpretative position based on expert tax advice that was also consistent with the commonly held industry view or the taxpayer confirms the position orally with Inland Revenue.

**Appropriate record keeping systems and other procedures**

A false statement arising from an oversight or an error in adding, subtracting or transposing amounts may result from a failure to take reasonable care, but such an error is not particular financial institution, there will not be a failure to take reasonable care unless the taxpayer knew or could reasonably be expected to know that the statement was wrong.

**Relying on information provided by a third party**

A statement may be false or misleading because it relies on incorrect information

obtained from a third party. Whether this reliance indicates a failure by the statement maker to exercise reasonable care will depend on an examination of all the circumstances.

**Example:**

Where a person returns interest income based on incorrect information provided by the third party.

A failure to respond to every foreseeable risk will not necessarily mean that reasonable care is absent. In each case the seriousness of the risk must be weighed against the cost of guarding against it

**Example:**

Where there is a remote risk that the accounting systems leave open the possibility of a minor error, but the risk is not addressed because the cost would be unaffordable, reasonable care is still likely to be shown.

**Tax agents relying on third party information**

Whether a tax agent shows reasonable care by relying on information provided by a client that is incorrect also depends on an examination of all the circumstances. The reasonable care standard is not so demanding as to require a tax agent to extensively audit, examine or review books and records or other source documents to independently verify the taxpayer's information. However, whilst it will not be possible or practical for an agent to examine every item of information supplied, reasonable enquiries must be made if the information appears to be incorrect or incomplete.

**Example:**

A firm of accountants may be negligent in preparing income tax returns if it does not check the accuracy of depreciation calculations prepared by an unqualified

bookkeeper employed by the client and the calculations were incorrect and resulted in an understatement of the plaintiff's taxable income. Negligence would be established because a reasonably careful accountant would have had grounds for questioning the correctness of the calculations to ensure that the information disclosed in the returns was accurate. This may be different to the case where a competent expert prepares the information that is relied upon.

### **Likelihood that a statement is false or misleading**

The likelihood of the risk that a statement is false or misleading is a relevant factor in deciding whether reasonable care has been exercised in making a statement to the Commissioner.

### **Relevance of the size of the tax shortfall amount**

The size of a shortfall or the proportion of a shortfall to the overall tax payable, arising from making a false or misleading statement, are indicators pointing to the magnitude of the risk involved in making the statement.

### **Example:**

A person dealing with a matter that involves a substantial amount of tax or involves a large proportion of the overall tax payable will be required to exercise a higher standard of care because the consequences of error or misjudgement are greater. However, all the individual circumstances leading up to the making of the false or misleading statement are to be weighed up in deciding whether reasonable care has been taken.

## **GROSS CARELESSNESS and RECKLESSNESS**

### *Meaning of recklessness as to the operation of a tax law*

The Commissioner considers that the words gross carelessness and recklessness are interchangeable in this context. Recklessness implies conduct that is more blameworthy than a failure to take reasonable care to comply with a tax law but is less blameworthy than an intentional disregard of a tax law.

A finding of recklessness or gross carelessness depends on the application of an essentially objective test. There must be the presence of conduct that falls short of the standard of a reasonable person in the position of the person.

Similar to the position with a failure to take reasonable care, dishonesty is not an element of establishing gross carelessness. The actual intention of the taxpayer is of no relevance.

### **Example:**

A person will have behaved recklessly if their conduct clearly shows disregard of, or indifference to, consequences or risks that are reasonably foreseeable as being a likely result of the person's actions. In other words, recklessness involves the running of what a reasonable person would regard as an unjustifiable risk.

The Commissioner considers that a person would be acting recklessly if:

- (a) the person did an act which created a risk of a particular consequence occurring (for example, a tax shortfall), and
- (b) a reasonable person who, having regard to the particular circumstances of the person, knew or ought to have known the facts and circumstances surrounding the act would have or



ought to have been able to foresee the probable consequences of the act, and

- (c) the risk would have been foreseen by a reasonable person as being great, having regard to the likelihood that the consequences would occur, and the likely extent of those consequences (for example, the size of the tax shortfall), or
- (d) when the person did the act, he or she either was indifferent to the possibility of there being any such risk, or recognised that there was such risk involved and had, nonetheless, gone on to do it. That is, the person's conduct clearly shows disregard of, or indifference to, consequences foreseeable by a reasonable person.

Dishonesty is a requisite feature of behaviour that shows an intentional disregard for the operation of the law.

Evidence of intention must be found through direct evidence or by inference from all the surrounding circumstances, including the conduct of the person.

A mere failure to follow the Commissioner's view contained in a private ruling is not evidence of intentional disregard. However, if a person ignores an unfavourable private ruling on a matter where the law is clearly established, that may constitute intentional disregard.

Intentional disregard of the law can be inferred from the facts and surrounding circumstances.

The facts must show that a person consciously decided to disregard clear obligations under a tax law, of which the person was aware.

Intentional disregard means that there must be actual knowledge that the statement made is false. To establish intentional disregards, the person must understand the effect of the relevant legislation and how it

operates in respect of the person's affairs and make a deliberate choice to ignore the law.

**Example:**

The production of false records will amount to an intentional disregard of a tax law.

A person does not intentionally disregard an obligation by taking a view that differs from the Commissioner's view, provided the view is not frivolous or unfounded.

**EXAMPLE**

If a person obtains an unfavourable ruling on a settled area of a law and they disregard the ruling without having an alternative view that is reasonably arguable, this may constitute intentional disregard because the law which formed the basis of the ruling is clear and has been explained to the person.

*For further examples see Appendix 1 of the Ruling PR 2024/2*

*For assessment and remission of administrative penalty see Public Ruling PR 2024/5*