

Guide to the meaning of reasonably arguable, and penalty for taking a tax position that is not reasonably arguable

Introduction

This Guide explains the meaning of what is and what is not a reasonably arguable position and what the penalty is for taking a tax position that is not reasonably arguable.

See *PR 2024/3 – meaning of, and penalty for taking a tax position that is not reasonably arguable*, available on the IRD website, for more details on this topic.

The Tax Administration Act 2022 imposes administrative penalties on taxpayer who exhibit certain types of behaviour, such as:

- making a false or misleading statement to a tax officer;
- failure to take reasonable care in taking a tax position;
- exercising gross carelessness in taking a tax position;
- taking a tax position in disregard of a clear tax law obligation with intent to reduce or remove a tax liability or obtain a tax benefit.

Meaning of taking a tax position

Tax position is defined in the Tax Administration Act 2022 to mean a position or approach with regard to tax under a tax law including, without limitation, a position or approach with regard to any one or more of the following:

- a liability for an amount of tax, or the payment of an amount of tax;

- an obligation to deduct or withhold an amount of tax, or the deduction or withholding of an amount of tax;
- a right to a tax refund, or to claim or not to claim a tax refund;
- a right to a credit of tax, or to claim or not to claim a credit of tax;
- the obligation to file or not file a return;
- the derivation of an amount of income, including exempt income or a capital gain, or the inclusion or non-inclusion of an amount in income;
- the estimation of the provisional tax payable;
- a right to a tax credit.

Meaning of reasonably arguable position

The Act provides that a tax position is reasonably arguable if, on an objective interpretation of the relevant law and its application to the facts of the case, the taxpayer's position is as likely to be correct as incorrect. This is subject to the following:

- A tax position that is contrary to a public or private ruling issued by the Commissioner is not capable of being a reasonably arguable position;
- A taxpayer does not take a tax position that is not a reasonably arguable position merely by making a mistake in the calculation or recording of

numbers used in, or for use in preparing, a return.

The rationale of a reasonably arguable position is that while all taxpayers would be penalised if they failed to exercise reasonable care, it was thought necessary that taxpayers, who on the facts of their case, make large claims for deductions should exercise greater care and therefore should have a reasonably arguable position.

Example:

Where the interpretation of the law for such large claims is in issue, we expect taxpayers to exercise more care; that is, the taxpayer must have exercised reasonable care and have a reasonably arguable position on the claim.

Differences between reasonably arguable and reasonable care

As stated in the Guide to *PR 2023/2 Meaning and Penalty relating to false and misleading statements, reasonable care, gross carelessness and intentional disregard*, the reasonable care test requires taxpayers to take the same care in fulfilling their tax obligations that could be expected of a reasonable person in the position of the taxpayer. This means that even though the standard of care is measured objectively, it takes into account factors such as the taxpayer's knowledge, education, experience and skill.

In contrast, there is no personal aspect to the reasonably arguable position test as it applies an objective standard involving an analysis of the law and application of the law to the relevant facts. It is not a question of whether a taxpayer thinks or

believes that its position is reasonably arguable, but simply whether it is actually reasonably arguable. This approach is taken because the reasonable care standard on its own is seen as insufficient in cases where the facts show a large adjustment because of the personal considerations relevant to the reasonable care test.

A higher standard is imposed where the reasonably arguable position test is applied in cases where the tax involved is a large amount than that required to demonstrate reasonable care in cases where the tax is not as large. Because of these differences, a taxpayer may not have a reasonably arguable position despite having satisfied the reasonable care test.

Although demonstrating a reasonably arguable position involves the application of a purely objective test, a taxpayer will usually reach their position (at the time of making the statement) as a result of researching and considering the relevant matters under the heading **matters that are relevant in determining whether a taxpayer has a reasonably arguable position at page 4**. In these circumstances, the efforts made by the taxpayer to arrive at the correct taxation treatment will also demonstrate that reasonable care has been shown.

Process for determining whether a position is reasonably arguable

The Act explains that a tax position is reasonably arguable if, on an objective interpretation of the relevant law and its application to the facts of the case, the taxpayer's position is as likely to be correct as incorrect.

The test does not require the taxpayer's position to be the better view. The Commissioner considers that "a better view" would be a view that would be accepted by the Courts as a better view. However, the **reasonably arguable position standard would not be satisfied if a taxpayer takes a position which is not defensible, or that is fairly unlikely to succeed in court.** On the contrary, the strength of the taxpayer's argument should be sufficient to support a reasonable expectation that the taxpayer could win in court. The taxpayer's argument should be forceful, well-grounded and considerable in its persuasiveness.

The following factors help provide guidance as to whether a position is reasonably arguable:

a) the test to be applied is objective, not subjective.

The Commissioner considers "**objective**" means making an unbiased, balanced observation based on facts which can be verified (proven), and applies the relevant law to them. Whereas "**subjective**" means making assumptions and making interpretations based on personal opinions rather than proven facts;

b) the decision maker considering the penalty must first determine what the argument is which supports the taxpayer's claim;

c) the decision maker will already have formed the view that the claim is wrong, otherwise the issue of penalty could not have arisen.

Hence **the decision maker** at this point **will need to evaluate the taxpayer's argument to determine if it is reasonably arguable;**

d) the **decision maker must then determine whether the taxpayer's argument,** although considered wrong, **is about as likely correct as not correct,** when regard is had, to an "objective interpretation of the relevant law and its application to the facts of the case";

e) It is **not necessary** that the decision maker **form the view that the taxpayer's argument** in an objective sense **is more likely to be right than wrong, rather** that the taxpayer's **position is as likely to be right as wrong.** That this is so follows from the fact that tax has already been short paid, that is to say the premise against which the question is raised for decision is that the taxpayer's argument has already been found to be wrong.

f) Nor can it be necessary that the decision maker form the view that it is just as likely that the taxpayer's argument is correct as the argument which the decision maker considers to be the correct argument for the decision maker has already formed the view that the taxpayer's argument is wrong. The standard is not as high as that. **The words 'is as likely' indicates the need for balancing the two arguments,** with the consequence that **there must be room for it to be argued which of the two positions is correct** so that on balance the taxpayer's argument

can objectively be said to be one that, while wrong, could be argued on rational grounds to be right;

- g) **A tax position could not be as likely as not correct if there is a failure on the part of the taxpayer to take reasonable care.** Hence the argument must clearly be one where, in making it, the taxpayer has exercised reasonable care. However, mere reasonable care will not be enough for the argument of the taxpayer must be such as, objectively, to be 'about as likely as not correct' when regard is to be had to the matters under the heading – **matters that are relevant in determining whether a taxpayer has a reasonably arguable position at page 4.**

The approach outlined above demonstrates that **the reasonably arguable position standard is an objective standard involving an analysis of the law and application of the law to the relevant facts.** All matters relevant to the tax treatment of an item, including the matters contrary to the treatment, are taken into account in determining whether a taxpayer has a reasonably arguable position.

The position must be a contentious area of law, where the relevant law is unsettled or where, although the principles of the law are settled, there is a serious question about the application of those principles to the circumstances of the particular case.

The question of whether the position taken by the taxpayer is reasonably arguable is determined by reference to

the law as it stood at the time the statement was made by the taxpayer.

Matters that are relevant in determining whether a taxpayer has a reasonably arguable position

- a taxation law;
- any material not forming part of the Act which is capable of assisting in the ascertainment of the meaning of the provision such as explanatory memoranda and second reading speeches;
- a decision of a court (whether or not a Solomon Islands Court); and
- a public ruling, Commissioner's Guides and other public documents.

The relevance of the above matters is to be weighed against the applicable statutory provisions and the facts of the case. A decision of a Solomon Islands Court will have greater weight than a decision of another jurisdiction Court if it is on the same law and facts.

The absence of any other matter for a particular position, other than the legislation itself, will not be detrimental to a taxpayer seeking to establish a reasonably arguable position. What is required is that the taxpayer has a well-reasoned construction of the applicable statutory provision from which it could be concluded that the tax position was about as likely as not the correct interpretation.

A tax position that is contrary to a public or private ruling issued by the Commissioner is **not** capable of being a reasonably arguable position.

If a taxpayer disagrees with the Commissioner's views, they should lodge their return in accordance with the public ruling and object to their self- assessment

or a Commissioner assessment and give their alternative view.

Alternative views expressed in public rulings are not necessarily equivalent to having a reasonably arguable position. However, the relevant matters used to support the alternative view may assist the taxpayer in formulating a reasonably arguable position in having penalties remitted.

Matters relating to other areas of law, such as contract law may provide support for a particular treatment of an item.

Other matters could also include statements in publications, such as tax articles on the topic, recognised by tax professionals as being relevant matters about how the law operates, particularly in cases where there are few matters on the correct treatment of an issue apart from the legislation itself. The relative weight to be given to each matter would depend on the circumstances.

In comparison, a taxpayer having an opinion expressed by an accountant, lawyer or other adviser is not of itself a relevant matter. Rather, the matters used to support or reach the views expressed by the accountant, lawyer or adviser, including a reasonable construction of the relevant statutory provisions, may support the position taken by a taxpayer. Accordingly, the Commissioner will consider the matters referred to in any opinion submitted by a taxpayer.

Documenting a reasonably arguable position

The provisions of the Act do not require a taxpayer to document their reasonably arguable position at the time that the statement is made. The Commissioner

considers that, whilst the reasonably arguable position is established at the time the statement is made, a taxpayer has the opportunity to demonstrate their position when a shortfall amount is identified, which may be a number of years later.

When a taxpayer provides their convincing reasons for taking a particular position, this will assist Inland Revenue to objectively and quickly determine whether a reasonably arguable position was taken at the time the statement was made. When providing these reasons, a discussion as to why the alternative arguments do not apply would be useful.

Although it is common practice for a taxpayer to provide supporting reasons for the position they have taken, the failure to do so does not by itself mean that the taxpayer does not have a reasonably arguable position. This is because the test is objective. Accordingly, in determining whether a taxpayer has a reasonably arguable position, Inland Revenue will consider all matters relevant to the tax treatment of an item, including contrary matters.

Administrative Penalty for taking a position that is not reasonably arguable.

A person will be subject to an administrative penalty where the person or their agent makes a statement to the Commissioner which treats a relevant tax law as applying to a situation (or identical situation) in a particular way that, when having regard to the relevant matter, is not reasonably arguable and there is a tax shortfall amount. Although a tax shortfall amount is not defined in the Act, the Commissioner considers that a tax

shortfall amount is the difference between the correct tax liability or credit entitlement, and the liability or entitlement worked out using the information a taxpayer provides.

As to the actual administrative penalty to be assessed, the Commissioner has issued a Public Ruling setting out the Commissioner's guidelines as to when he will reduce penalties from the maximum prescribed amount (see *Guide to understanding when the Commissioner will reduce penalties from the maximum prescribed amount based on Culpability and remission of administrative penalties PR 2023/4*).

Example 1 – Errors of fact

The reasonably arguable position test only applies to shortfall amounts caused by a taxpayer treating a relevant tax law as applying in a particular way. This occurs where the taxpayer concludes that, on the basis of the facts and the way the law applies to those facts, a particular consequence follows.

However, a taxpayer's conclusions on a particular matter may have been based on incorrect primary facts which the taxpayer did not know and could not reasonably be expected to have known were not the true facts.

Example

Where a taxpayer relies on a bank to provide details of the amount of interest earned on a deposit. In other cases, the statements in a taxpayer's return may not represent conclusions of the taxpayer, but might reflect errors in calculation or transposition errors.

As a broad rule, where a shortfall amount was caused by an error of fact or

calculation, the 'no reasonably arguable position' penalty will not apply since the taxpayer has not treated a relevant tax law as applying to a matter in a particular way.

In this context, errors of fact are errors of primary fact and not wrong conclusions of fact which a taxpayer may make which bear on the correct application of a tax law, such as whether the taxpayer is carrying on a business. Whether the statements in a taxpayer's return represent conclusions of the taxpayer or were caused by errors of fact or calculation should be determined on the basis of all the available evidence. Note that where there is an error of fact it may be necessary to consider whether the taxpayer has taken reasonable care.

Example 2 – Error of fact – income tax matter

Bill, when looking up the effective life of a particular asset, mistakenly selects the wrong effective life.

Bill knows the relevant asset category but accidentally selects the effective life for the asset category listed next to the correct one. Although Bill has claimed a deduction for decline in value using the incorrect effective life as a result of this error, it does not involve treating an income tax law as applying in a particular way.

In these circumstances, the 'no reasonably arguable position' penalty will not apply because Bill has not treated an income tax law as applying to a matter in a particular way.