

Public Ruling

PR 2024/3 –meaning of, and penalty for taking a tax position that is not reasonably arguable

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PREAMBLE: This publication is a Public Ruling made under the Tax Administration Act 2022. The number, subject heading, what this Ruling is about (including Class of person/arrangement section), Date of effect, and Ruling parts of this document are a 'public ruling' for the purposes of section 149 of the Taxation Administration Act 2022 and are legally binding on the Commissioner. The remainder of the document is administratively binding on the Commissioner.

WHAT THIS RULING IS ABOUT

1. This Ruling gives the Commissioner's interpretation of what constitutes a reasonably arguable position for the purposes of Part 8 of the Tax Administration Act 2022 (the Act).
2. This Ruling also sets out the Commissioner's views on the imposition of an administrative penalty for taking a position that is not 'reasonably arguable'

Class of person/arrangement or transaction

3. This Ruling applies to a position taken by a person in respect of a tax law.

Background

4. The administrative penalty regime contained in the Act applies from 1st January 2023 to all taxes administrated by the Commissioner.
5. The regime sets out uniform administrative penalties that apply to persons that fail to satisfy certain obligations under different tax laws.

6. The administrative penalty provisions consolidate and standardise the different penalty regimes that previously existed in the various tax Acts administered by the Commissioner.
7. Division 3 of Part 8 of the Act imposes penalties for:
- failure to keep and maintain the tax records required by a tax law;
 - failure to apply for a TIN;
 - failure to update TIN information;
 - failure to display a tax agent certificate;
 - late filing;
 - false or misleading statement to a tax officer;
 - failure to take reasonable care in taking a tax position;
 - 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.
8. This Ruling considers that last 4 types of penalties so far as the term “reasonably arguable position” is used in section 119 (Administrative penalty for false or misleading statement); section 120 (Administrative penalty for not taking reasonable care); section 121 (Administrative penalty for gross carelessness) and section 122 (Administrative penalty for intentional disregard).

RULING

Legislative framework

Meaning of tax position

9. Section 110 of the Act provides that, in sections 111 and 120 to 122, “**tax position**” means 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) a liability for an amount of tax, or the payment of an amount of tax;
- (b) an obligation to deduct or withhold an amount of tax, or the deduction

or withholding of an amount of tax;

- (c) a right to a tax refund, or to claim or not to claim a tax refund;
- (d) a right to a credit of tax, or to claim or not to claim a credit of tax;
- (e) the obligation to file or not file a return;
- (f) 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;
- (g) the estimation of the provisional tax payable;
- (h) a right to a tax credit.

Meaning of reasonably arguable position

10. Section 111 of the Act provides that in sections 119 to 122, 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.

11. 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.

12. 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

13. Under a self-assessment system all persons are expected to exercise reasonable care in the conduct of their tax affairs.
14. As stated in PR 2023/2 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.
15. 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.
16. In this sense, 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.
17. 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 in paragraph 24 below. 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

18. Subsection 111(1) of the Act explains when a tax position is reasonably arguable. The section 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.

19. 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.
20. 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 in paragraph 24.

21. 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.

22. In other words, 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.

Having regard to an objective interpretation of the relevant law and its application to the facts of the case

23. 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.

24. The following matters 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.

25. 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.
26. 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 in such cases 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.
28. As the reasonably arguable position standard is an objective standard, all matters relevant to the tax treatment of an item, including matters contrary to the treatment, are taken into consideration in determining whether a taxpayer has a reasonably arguable position.
29. Where the public ruling is about a relevant tax law, section 111(3) provides that 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.
30. In other words, taxpayers should take particular note of the Commissioner's views on the operation of the law as expressed in such a public ruling and adopt them when preparing returns. If they disagree 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.
31. Where there are significant alternative views in relation to the interpretation or application of the law adopted in a public ruling, the ruling will usually acknowledge the existence of those alternative views.
32. 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.
33. Matters relating to other areas of law, such as contract law may provide support for a particular treatment of an item.

34. 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.
35. 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

36. The general administrative penalty provisions 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.
37. When a taxpayer provides their convincing reasons for taking a particular position, this will assist Inland Revenue to objectively and expeditiously 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.
38. 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

39. 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.

40. 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 PR 2023/4).

DATE OF EFFECT

41. This Ruling applies from the date of effect of the Tax Administration Act 2022, namely 1st January 2023. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling.

Joseph Dokekana
Commissioner Inland Revenue
Date: 31st May 2024

APPENDIX 1

Example 1 - Errors of fact

42. 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.
43. 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. An example is 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.
44. 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.
45. 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

46. 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.
47. 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.