BY AUTHORITY

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## LEGAL NOTICE

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**TAX ADMINISTRATION ACT 2022**
(No. 3 of 2022)

**PUBLIC RULING 2024/1**

# PUBLIC AND PRIVATE RULINGS SYSTEM - EXPLANATION AND STATUS

This Ruling is a public ruling within the meaning of section 149 of the Tax Administration Act 2022 (TAA).

**Table of contents**



## PREAMBLE

The Public and Private Rulings system has been introduced from 1 January 2023:

(a) in the case of Public Rulings, it is a means of publishing decisions on interpretation of the laws administered by the Commissioner; and

(b) in the case of Private Rulings, it sets out the Commissioner's position on application by a taxpayer regarding how a tax law applies or would apply to the particular taxpayer and to an arrangement for which the ruling is sought.

## INTRODUCTION

1 Section 149 of the TAA authorises the Commissioner of Inland Revenue to make public rulings setting out how a tax law applies in relation to a type of person or type of arrangement.

2 Section 153 of the TAA authorises the Commissioner to make a private ruling.

3. This Ruling explains how the Commissioner will make Public and Private Rulings in accordance with the TAA.

4 Public rulings express the Commissioner's interpretation of the laws he or she administers which applies to all taxpayers. A private ruling is binding advice that sets out how a tax law applies to a particular person in relation to a specific arrangement or circumstance.

## PUBLIC RULINGS

### The Commissioner is bound by a public ruling

5 The Commissioner is bound by a public ruling made in accordance with section 150 of the TAA until withdrawn. This means that the Commissioner is not able to use a position that conflicts with a position he has taken in a public ruling as the basis for assessing a person for a liability to pay income tax for example. However, as explained below, the Commissioner can replace a public ruling with a new one that is based on a revised interpretation of a tax law.

6 A person who follows a position taken by the Commissioner in a public ruling will not be liable to administrative penalties even if that position is subsequently held by a court not to be a correct interpretation of the law.

### Public rulings are not binding on taxpayers

7 A public ruling is not binding on a person liable to pay tax. If a person believes the Commissioner's interpretation of the law set out in a public ruling is incorrect, the person may appeal an assessment made on the basis of the position taken by the Commissioner in a public ruling. If a person takes a position contrary to a position taken by the Commissioner in a public ruling and it is subsequently determined that the Commissioner's view is a correct interpretation of the law, the person will be liable for the tax due under the Commissioner's interpretation.

8. In addition, depending on the circumstances behind the person's decision to adopt a position contrary to the Commissioner's interpretation of the law, the person may be liable for administrative penalties imposed under the TAA.

9. Factors that will affect a possible liability to administrative penalties include:

(a) whether the taxpayer disclosed to the Commissioner that the taxpayer was taking a position that conflicted with the Commissioner's interpretation of the law;

(b) whether the taxpayer's position was based on a contrary interpretation in

the law that a court would consider to be an arguable position;

(c) whether the taxpayer took a contrary position:

(i) unaware of the Commissioner's position through disregard, carelessness, inattention; or

(ii) unaware of the Commissioner's position through negligence;

(iii) aware of the Commissioner's position, but having grounds to believe it may not have been correct; or

(iv) aware of the Commissioner's position and having no reasonable grounds to believe it may not have been correct.

**Procedure for making public rulings**

10 Section 150 of the TAA sets out the procedure for making a public ruling. It provides that:

(a) the Commissioner makes a public ruling by publishing the ruling in the Gazette;

(b) the Commissioner will also publish the ruling on an Inland Revenue Division's internet site to which the public has free access.

(c) A public ruling will:

(i) state that it is a public ruling made under the TAA; and

(ii) have a number and subject heading by which it can be identified.

(d) A public ruling applies from the date specified in the ruling or, if no date is specified, from the date of publication in the Gazette.

(e) A public ruling has effect despite, and must not be invalidated for, an error or defect in procedure, form or detail that does not affect the substance or effect of the ruling.

**Commissioner may amend or withdraw public rulings**

11 The Commissioner may amend a public ruling or withdraw a public ruling, in whole or in part. The Commissioner must publish the amendment or withdrawal in the Gazette.

12 A public ruling is treated as withdrawn, and not to have effect, to the extent that it is inconsistent with either a subsequent tax law or amendment to a tax law; or a subsequent public ruling.

**Effect of amendment or withdrawal of public ruling**

13 The amendment of a public ruling takes effect on and from the date specified in the notice of amendment or, if no date is specified, on or from the date of publication in the Gazette. However, the amendment of a public ruling does not apply to an arrangement that commenced before the ruling takes effect.

14 The withdrawal of a public ruling or part of it takes effect:

(a) Where the Commissioner withdraws a public ruling, in whole or in part by publishing the withdrawal in the Gazette,

(i) on and from the date specified in the notice of withdrawal or,

(ii) if no date is specified, on or from the date of publication in the Gazette; or

(b) Where a public ruling is treated (deemed) as withdrawn and not to have effect to the extent that it is inconsistent with a subsequent law or amendment to a tax law,

(i) on and from the date on which the subsequent tax law or amendment commences or otherwise takes effect; or

(c) Where a public ruling is treated (deemed) as withdrawn and not to have effect to the extent that it is inconsistent with a subsequent public ruling,

(i) on and from the date that the new ruling applies.

15 A public ruling that has been withdrawn, in whole or in part:

(a) continues to apply to an arrangement that commenced before the ruling was withdrawn; and

(b) to the extent that the ruling is withdrawn, does not apply to an arrangement that commenced after the ruling was withdrawn.

16 The Commissioner may replace a public ruling at any time with a new public ruling.

17 Where a public ruling replaces a previous one, the later ruling will clearly indicate that taxpayers may rely on the new ruling and that the former ruling may no longer be relied upon by taxpayers.

18 A ruling that replaces another ruling will also provide transitional rules for taxpayers who had sought to rely upon the former ruling. A replaced ruling will continue to be valid and binding on the Commissioner for all tax periods that have concluded at the time of the new ruling. The replacement ruling will indicate under what circumstances, if any, taxpayers may rely on the replaced ruling for the tax period in which the replacement ruling is issued or for future tax periods.

**Private rulings**

Commissioner may make private rulings

19 Section 153 of the TAA authorises the Commissioner to make a private ruling setting out the Commissioner's position on application by a taxpayer regarding how a tax law applies or would apply to a particular taxpayer and to an arrangement for which the ruling is sought.

20 The term "arrangement" is defined in section 3 of the TAA to mean any contract,

agreement, plan, or understanding, whether express or implied and whether legally enforceable or not".

21 The Commissioner may make a private ruling on the basis of assumptions about a future event or other matter as the Commissioner considers appropriate.

**Effect of Private ruling**

22 A private ruling is binding on the Commissioner in relation to the taxpayer who applied for it, in the approved form (see the Private Ruling Application Form available on the IRD website (www.ird.gov.sb ), on condition that:

(a) the taxpayer has made full and true disclosure of all aspects of the arrangement in question that are relevant to making the ruling; and

(b) the arrangement has proceeded in all material respects as described in the taxpayer's application for the ruling. The Commissioner considers something is material if it would have resulted in a different ruling had the Commissioner been aware of it when the original ruling was made.

23 "***Binding on the Commissione***r" means that the Commissioner cannot use a position that conflicts with a position he has taken in a private ruling as the basis for assessing the recipient of the private ruling for a liability to pay tax. However, a private ruling given by the Commissioner will only be binding on the Commissioner in respect of the particular arrangement and for the tax period or periods for which a person requests a ruling unless there is an explicit indication to the contrary in the ruling.

24 Further, the arrangement must have proceeded in all material respects as described in the taxpayer's application for the ruling.

25 Because a private ruling is binding on the Commissioner only if the person seeking the ruling has provided a full and true disclosure of all aspects of the arrangement or planned arrangement relevant to the ruling, a private ruling cannot be relied upon by any person other than the person to whom it was issued.

26 If both a private ruling and a public ruling apply to or in relation to a taxpayer, the private ruling prevails, and the public ruling does not apply, to the extent of any inconsistency between the rulings.

**Commissioner may refuse to make private rulings**

27 The Commissioner may refuse an application for a private ruling on any of the following grounds:

(a) the Commissioner has in an assessment already decided the matter that is the subject of the application; or

(b) the Commissioner considers that a current public ruling adequately covers the matter that is the subject of the application; or

(c) the application relates to a matter that is the subject of a tax audit or an

objection; or

(d) the application is frivolous or vexatious, the Commissioner considers that frivolous means something that is not worth serious attention, while vexatious means that the application is made simply for the purpose of wasting time or for causing delay; or

(e) the arrangement to which the application relates has not been carried out and there are reasonable grounds for believing that it will not proceed; or

(f) the applicant has provided the Commissioner with insufficient information for making a private ruling; or

(g) the Commissioner considers that it would be unreasonable to make a private ruling in view of the resources available to the Commissioner.

28 The Commissioner must serve the applicant with written notice of a refusal to make a private ruling.

**Procedure for making private rulings**

29 The Commissioner makes a private ruling by serving a written notice of the ruling on the applicant.

30 The law provides that a private ruling must set out the matter ruled on, identifying:

(a) the taxpayer; and

(b) the tax law relevant to the ruling; and

(c) the tax period to which the ruling applies; and

(d) the arrangement to which the ruling relates; and

(e) any assumptions on which the ruling is based.

31 Attached at Appendix B is the template the Commissioner intends to use to make private rulings.

**Commissioner may withdraw a private ruling**

32 The Commissioner may at any time withdraw a private ruling by service of a notice of withdrawal on the taxpayer. A private ruling is treated as withdrawn to the extent that it is inconsistent with:

(a) a subsequent tax law or amendment to a tax law; or

(b) a subsequent public ruling.

**Effect of withdrawal of private ruling**

33 The withdrawal of a private ruling or part of it takes effect:

(a) where the Commissioner withdraws a private ruling by service of notice of withdrawal on the taxpayer: on and from the date specified in the notice of withdrawal; or

(b) where a private ruling is treated as withdrawn to the extent that it is inconsistent with a subsequent tax law or amendment to a tax law: on and from the date on which the subsequent tax law or amendment commences or otherwise takes effect; or

(c) where a private ruling is treated as withdrawn to the extent that it is inconsistent with a subsequent public ruling: on and from the date that the public ruling applies.

34 A private ruling that has been withdrawn, in whole or in part:

(a) continues to apply to an arrangement that commenced before the private ruling was withdrawn; and

(b) to the extent that the private ruling is withdrawn, does not apply to an arrangement that commenced after the private ruling was withdrawn.

**Publication of Rulings**

35 The Commissioner makes a public ruling by publishing the ruling in the Gazette. The Commissioner will also publish a public ruling on an Inland Revenue Division's internet site to which the public has free access.

36 Private rulings will not be published.

Date this thirty-first day of May 2024

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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***Legislative references:*** *public and private rulings TAA PART 9 Divisions 1 and 2 sections 149 to 152 and 153 to 158*

## APPENDIX A
## PRIVATE RULING TEMPLATE
## NOTICE OF PRIVATE RULING

This ruling is a private ruling for the purposes of section 153 of the Tax Administration Act 2022.

***This Private Ruling applies to***: Name of the person to whom the ruling is to apply to, address- postal and email and TIN

***Tax Period(s) to which this Private Ruling applies***: For income tax matters, this will generally be the particular income year. In Goods Tax matters, this will be the relevant period in which the transaction occurred or will occur.)

***Tax Law(s)***: The provision(s) of the relevant Act on which the applicant is seeking a private ruling.

***What this Private Ruling is about***: Sets out the question(s) asked clearly including sub-questions.

***The subject of the Private Ruling***: This is where the facts of the arrangement are set out. If the facts are detailed in documents the facts in those documents are set out here.

***Commencement of arrangement***: If known, the date the arrangement commenced or will commence.

***Assumptions***: If none, then nil. Otherwise, all assumptions made are to be clearly stated.

***Private Ruling***: This is the short answer to the question(s) posed in the 'what this private ruling is about section' of this notice.

Date this thirty-first day May 2024

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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***Explanation:***

*it is not legally binding. It should detail the legal analysis, that is, the application of the facts to the law.*

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**INFORMATION ABOUT THIS PRIVATE RULING**

You are advised that this ruling is based on the information provided in your ruling application. This private ruling shall be binding on the Commissioner Inland Revenue provided:

(a) the facts stated in the application regarding the arrangement or proposed arrangement are not materially different from the arrangement actually carried out; (a fact is considered material if it would have resulted in a different ruling had the Commissioner been aware of it when the original ruling was made); and

(b) you have made a full and true disclosure of all aspects of the arrangement relevant to the ruling, that is, there is no misrepresentation or no wilful nondisclosure of a material fact; and

(c) any condition or assumption stipulated by the Commissioner as a condition of the issue or binding effect of ruling has been satisfied or carried out.

If any of the above apply that is:

(a) the facts are materially different, or

(b) there has not been a full and true disclosure or

(b) a condition has not been satisfied or carried out or assumption is incorrect,

the ruling will be of no effect and be not binding on the Commissioner.

If both a private ruling and a public ruling applies to or in relation to a taxpayer, the private ruling prevails, and the public ruling does not apply, to the extent of any inconsistency between the rulings.

However, if the Commissioner publishes a subsequent public ruling that is inconsistent with the private ruling, the private ruling shall be treated as withdrawn to the extent of any inconsistency.

**The withdrawal of a private ruling, in whole or in part, takes effect:**

(a) if the Commissioner has withdrawn your private ruling by serving written notice on you, from the date specified in the notice of withdrawal; or

(b) if the Commissioner has issued an inconsistent public ruling, from the date of application of the inconsistent public ruling.

**A private ruling that has been withdrawn shall:**

(a) continue to apply to an arrangement commenced before the private ruling was withdrawn; and

(b) not apply to an arrangement commenced after the private ruling was withdrawn to the extent that the ruling is withdrawn.

***NOTE:***

A ruling ceases to have effect if any of the following occur:

(a) if the provision of the relevant Act that was the subject of the ruling is repealed or amended, the ruling will cease to be effective from the date such repeal or amendment is effective; or

(b) if a court overturns or modifies an interpretation of the relevant Act on which the ruling is based, the ruling will cease to be effective from the date of the court's judgment unless:

(i) the decision is under appeal; or

(ii) the decision is fact specific and the general interpretation upon which the ruling was based is unaffected; or

(iii) the reference to the interpretation upon which the ruling was based was "obiter dicta" (that is, the interpretation was not part of the binding decision of the Court).

The ruling ceases immediately upon occurrence of events above whether or not the Commissioner has not published a notice of withdrawal or modification.

This ruling may be withdrawn by written notification given to the applicant, provided that the Commissioner must first give the Applicant notice of the proposed withdrawal or modification and a reasonable opportunity to state any proposition of law or fact relevant to the decisions to withdraw or modify the ruling.

This Ruling is a tax decision for the purposes of the Tax Administration Act 2022 (TAA) and if you are dissatisfied with the decision you may object to the decision in accordance with section 55 of the TAA.

**PUBLIC RULINGS**

I, Joseph Dokekana, Commissioner of Inland Revenue, under section 150 of the *Tax Administration Act 2022*, make the following public rulings as set out in the Schedule:

**SCHEDULE**

**PUBLIC RULINGS**
(section 150)

**NOTICE OF WITHDRAWAL OF MT PUBLIC RULINGS 2019/1:**

**MISCELLANEOUS TAXES: OFFSET OF TAX CREDITS AGAINST ARREARS OF TAXES**

**PREAMBLE**

This withdrawal is made under section 151 of the Tax Administration Act 2022 (the Act).

MT PR 2019/1 is treated as withdrawn, and not to have effect, to the extent that it is inconsistent with the Tax Administration Act 2022 (TAA) and takes effect from the date the TAA Act takes effect, namely 1 January 2023.

However, Public Ruling MT PR 2019/1 that has been withdrawn continues to apply to an arrangement that commenced before the ruling was withdrawn; and does not apply to an arrangement that commenced after the date the ruling was withdrawn.

**What this Withdrawal is about**

1 This Notice of Withdrawal of MT PR 2019/1 is as a result of the Introduction of section 69 in the TAA and the repeal of section 47 (1) and (2) of the Goods Tax Act Cap 122.

2 In MT PR 2019/1, the Commissioner provided guidance on when the Commissioner will allow tax credits to be:

(a) used by a taxpayer to offset tax arrears:

(b) in other periods for the same tax type;

(c) in other tax types for the same taxpayer; and

(d) of another taxpayer, but only with the approval of the Commissioner.

**RULING**

**Legislation**

3 Whilst section 90 of the Income Tax Act remains operative after the introduction of the TAA, subsections 47(1) and (2) of the Goods Tax Act Cap 122 have been

repealed.

4 Section 69 of the TAA now provides for the transfer of excess tax for all taxes.

5 The section provides that the Commissioner may transfer part or all of excess tax paid by a taxpayer to another tax period or another type of tax the taxpayer is liable to pay.

6. Further, the Commissioner may make the transfer on the Commissioner's own initiative or on the request of the taxpayer.

**DATE OF EFFECT**

7 This withdrawal applies to arrangements entered into on or after the 1st January 2023.

Dated this thirtieth-day of May 2024.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**PUBLIC RULINGS**
(section 149)

**PUBLIC RULING 2024/2:**

**MEANING AND PENALTY RELATING TO FALSE AND MISLEADING STATEMENTS, REASONABLE CARE, GROSS CARELESSNESS AND INTENTIONAL DISREGARD.**

## PREAMBLE

**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 false and misleading statement for the purposes of section 119 of the Tax Administration Act 2022 (TAA) which imposes an administrative penalty for a person making a false or misleading statement. Section 130 of the TAA makes the false and misleading statement a tax offence as well.

2 The Ruling also gives the Commissioner's interpretation of the concepts of reasonable care, gross carelessness and intentional disregard for the purposes of sections 120, 121 and 122 of the TAA respectively.

### Class of person/arrangement or transaction

3 This Ruling applies to a statement or actions made by a person in respect of a tax law.

### Background

4. The administrative penalty regime contained in the TAA 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 Tax Acts

7 Broadly, Division 3 of Part 8 of the TAA imposes penalties such as:

(a) failure to keep and maintain the tax records required by a tax law;

(b) failure to apply for a TIN;

(c) failure to update TIN information;

(d) failure to display a tax agent certificate;

(e) late filing;

(f) false or misleading statement to a tax officer;

(g) failure to take reasonable care in taking a tax position;

(h) gross carelessness in taking a tax position;

(i) 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 the last 4 types of penalties.

## RULING

### False or misleading statement What is a statement?

9 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.

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

(a) correspondence;

(b) responses to requests for information;

(c) a notice of objection;

(d) a request for an amendment to an assessment;

(e) an answer to a questionnaire; or

(f) connection with an audit or investigation.

11 In the context of self-assessment, where persons determine their own tax liabilities and pay the amounts due by dates specified in the law, a statement will 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.

12 Entering an amount at a label on a return will generally be a statement of mixed

fact and law in so far as it indicates that the amount returned was received, expended or withheld etc, and that the amount was the correct amount assessable, deductible or reportable etc.

13 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. Although at first it appears that no statement was in fact made, the person will be taken to have made a negative statement, for example, that there was no liability or that an event did not occur.

14 However, 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 under subsection 121 of the TAA for **gross carelessness** for failing to provide a document necessary for determining a tax related liability and under section 118 for late filing by failing to lodge a return, statement, notice or other document on time.

15 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?**

16 Whether a statement is false is a question of fact. Although it is not defined in the TAA, 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.

17 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.

18 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.

19 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.

**Did the person who made the statement not know and could not reasonably be expected to know that the statement was false or misleading in a material particular?**

20 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.

21 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.

22 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. It is generally the case though, that 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.

23 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.

24 It should be noted that generally no one factor, taken in isolation, will be sufficient to determine knowledge or the lack of knowledge. All the circumstances need to be considered and it is a question of degree as to the relevance of a particular factor.

25 A person may make a statement about their own tax affairs or about the tax affairs of a person which the person represents. Determining what would amount to knowledge in the circumstances of the person involves recognition of that person's:

(a) personal circumstances (such as age, health and background)

(b) level of knowledge, and/or

(c) understanding of the tax laws.

26 The physical and mental health, and the age, of a person can be relevant in determining whether they could be expected to have knowledge. For example, when a person's incapacity is serious enough that it infringes on most aspects of their daily life, it is more likely that they will be found not to have knowledge for a person in that situation. By contrast, a person in full health may be taken to have knowledge or reasonably expected to have that knowledge.

27 Other factors that may be relevant include the person's level of tax knowledge and level of education. The higher the level of tax knowledge or education, the more likely it is that the person is able to understand what is necessary when making statements to the Commissioner. Those with a more comprehensive understanding are expected to demonstrate they have met and exercised a higher standard when providing information to the Commissioner.

28 New entrants to the tax system will generally have a lower level of knowledge

and understanding of the tax laws than persons who have been i n the tax system for some time. New entrants will not be penalised for false or misleading statements in their first year if they have made a genuine attempt to comply with tax obligations. However, the new entrant will be liable to a penalty under section 119 of the TAA if they have used the services of a registered tax agent and the agent is considered to have knowledge or reasonably expected to have that knowledge. New entrants do not include businesses whose principals have previously been involved in business operations.

29 Where substantial tax law changes impact on a person's ability to understand their entitlements or obligations under the law and as a result the person makes a false or misleading statement, provided that they have made a genuine attempt to comply with the new statutory requirements:

(a) in the first 12 months from the date of application of the new law, or

(b) if there is an extended transitional period, during that transitional period, the person will not be considered to have knowledge or reasonably expected to have knowledge that the statement was false or misleading in making a statement.

30 Where a person claims to have made a genuine attempt to comply with substantial changes in the law the objective facts or reasonable inferences should support this claim. Where there is evidence of an attempt to avoid or disregard the requirements of the law, the person will not have made a genuine attempt to comply.

31 Further circumstances to be taken into account when determining whether a person is considered to have knowledge or reasonably expected to have that knowledge include:

(a) the relative size of the shortfall compared to the person's tax liability;

(b) the type of the item reported and the relative size of the discrepancy between what was reported and what should have been reported;

(c) the complexity of the law and the transaction (the difficulty in interpreting complex legislation); and

(d) the difficulty and expense associated with taking action to reduce or eliminate the risk of making an error.

32. 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.

33. Factors indicating that a person is considered to have knowledge or reasonably expected to have that knowledge include:

(a) taking an interpretative position with respect to an item that is frivolous or which lacks a rational basis;

(b) repeated errors where the person has been advised or is otherwise aware that mistakes have previously been made;

(c) 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

(d) an error which results from the inadequate training of staff, in particular inexperienced or temporary staff.

34 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.

35 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.

36 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.

37 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 section 119 penalty on the understatement.

**Reporting tax obligations**

38 Where a person makes a statement based on a conclusion reached as a result of interpreting the law in a particular way, the conclusion must be reasonable for an ordinary person to come to in the same circumstances.

39 If a person is uncertain about the tax treatment of an item, the person should make reasonable enquiries to resolve the issue. If they do not, the conclusion they have reached as a result of interpreting the law in a particular way may not be a reasonable conclusion that an ordinary person would come to in the same circumstances. Reasonable enquiries would generally include consulting a registered tax agent, contacting Inland Revenue or consulting an Inland Revenue publication on the website or other authoritative reference in an effort to satisfy the person about the appropriate tax treatment of the item. However, a failure to provide adequate information when seeking advice, a failure to provide reasonable instructions to a registered tax agent, or unreasonable reliance on a registered tax agent or on wrong advice may still expose the person to a penalty for providing a false and misleading statement.

40 The reading of what a person believes to be the relevant provision of a tax law might not constitute a reasonable enquiry unless the person had reasonable grounds for believing that they had understood the requirements of the law.

41 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.

42 Where a person or their agent adopts a tax treatment that is not consistent with the Commissioner's view, no knowledge or not reasonable to expect the person to have that knowledge will apply where they have made a genuine effort to research the issue and there is some basis for the position adopted.

43 However, if a person obtains a private ruling on the application of a tax law and disregards the ruling, this may constitute knowledge that the statement was false or misleading where a genuine effort was not made to research the issue. Alternatively, where the statement relates to a tax law, the person will be liable to the section 119 penalty.

44 If the position is reasonably arguable (see Public Ruling PR 2023/3) and a genuine effort was made to arrive at that position then it may be considered that the person does not have knowledge or is not reasonably expected to have that knowledge irrespective of the amount of the shortfall.

45 Deciding whether the person or registered tax agent has satisfied the knowledge

test will depend on whether the process taken to reach the position was reasonable in the circumstances. The more substantial the amount of the shortfall, the greater the degree of knowledge needed which should be taken prior to adopting a position.

46. 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 an agent**

47 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. For 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.

48 If a person has used the services of a registered tax agent, both the person and the agent must pass the knowledge test. Where the person's agent may be considered to have knowledge or reasonably expected to have knowledge that the statement was false or misleading, the person will be held liable for any penalty imposed.

49 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:

(a) properly record matters relating to tax affairs;

(b) provide honest, accurate and complete information in response to questions asked by the agent; and

(c) 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.

50 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 tak

en 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.

51 The knowledge required by a registered tax agent is higher than that expected of an ordinary person due to the knowledge, education, skill and experience of the practitioner obtained from continual exposure to the operation of the financial system and similar transactions for numerous clients. When examining a person's affairs, a registered tax agent would be expected to apply this experience to the person's situation and to ask the questions necessary to correctly prepare the client's return. However, this does not mean that a registered tax agent will always be expected to display the highest level of skill or foresight of which anyone is capable. The standard is that of a prudent professional of normal intelligence in the circumstances of the registered tax agent

**Who is liable for the penalty?**

52 Generally, where a statement is made by a person's authorised representative, the person will be liable for the penalty. For example, a company will be liable for false or misleading statements made by an employee, public officer or director.

**Knowledge test**

53 A person should be assumed to have knowledge unless the facts or reasonable inferences suggest otherwise. Where there is some doubt as to whether the person has the appropriate level of knowledge they should be contacted and given the opportunity to explain their level of knowledge prior to making the penalty decision. Conclusions about the level of knowledge a person has should only be made where it is supported by evidence. If the person and their agent have demonstrated that they do not have or could reasonably be expected not to have that knowledge in making the false or misleading statement, then no penalty should be imposed under section 119 because of the provision in subsection 119(2), which provides for no penalty where:

(a) the statement is made by a taxpayer in making a self-assessment return; and is a reasonably arguable position because the person has followed the Commissioner's position or tax laws; or

(b) the person who makes the statement does not know and could not reasonably be expected to know that the statement is false or misleading in a material particular.

54 Where the Commissioner has already determined that for the purpose of section 119 the person had the knowledge in making the false or misleading statement, it follows that the person cannot reasonably be expected to not have that knowledge. Similarly, if a person is reckless or has shown an intentional disregard of a tax law then they cannot be said not to have knowledge.

**REASONABLE CARE**

**Meaning of reasonable care**

55 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.

56 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.

57 Reasonable care requires a taxpayer to make a reasonable attempt to comply with the provisions of the tax laws and regulations. The effort required is one appropriate with all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.

58 Judging whether there has been a failure to take reasonable care turns on an assessment of all the circumstances surrounding the making of the false or misleading statement to determine whether a reasonable person of ordinary judgement in the same circumstances would have exercised greater care.

59 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.

60 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.

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

62 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.

63 It is only a failure to take reasonable care to comply with a tax law that gives rise to an administrative penalty. The penalty regime therefore does not apply to a failure to take reasonable care to comply with obligations under laws that are not tax laws.

64 The reasonable care test has regard to the efforts taken by a person or their agent to comply with their tax obligations.

**No presumption that there is a failure to take reasonable care where there is a false or misleading statement**

65 There is no presumption that the existence of a shortfall amount caused by a false or misleading statement necessarily or automatically points to a failure to take reasonable care. Similarly, in cases where there is no shortfall, there is no presumption that the making of the false or misleading statement automatically points to a failure to take reasonable care. The evidence must support the conclusion that the standard of care shown has fallen short of what would be reasonably expected in the circumstances.

66 Case law in Australia has indicated that, in the ordinary case, 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.

**Importance of individual circumstances**

67 A failure by a person or their agent to take reasonable care depends on all of the relevant acts or omissions leading to the false or misleading statement. Liability to a penalty will only arise where the particular conduct falls short of the standard of care expected of a reasonable person in the same circumstances. In other words, identifying what ought to have been done or ought not to have been done to avoid the risk of making a statement that is false or misleading reinforces the imposition of penalty for failing to take reasonable care.

68 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:

(a) personal circumstances (such as age, health, and background);

(b) level of knowledge, education, experience and skill; and

(c) understanding of the tax laws.

69 Another consideration that influences the standard of care that is reasonable in the circumstances is the class of person concerned. 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.

**Personal circumstances**

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

71 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**

72 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.

73 For 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.

74 Similarly, a taxpayer who is a senior officer in Inland Revenue should, because of his position and experience, be aware that income from his wife's and his business was taxable and by not including it in his income under section 48 of the income Tax Act would be a failure to take reasonable care. The spouse had been conducting a business of buying and selling cars in partnership with her husband and the income from this activity meant it was income of the husband under the Act and a person in the husband's position would have had a greater knowledge of the requirements of the Act and responsibilities of the taxpayer than an ordinary citizen and that the volume and frequency of such transactions could lead to a view that the profits were assessable.

75 In determining whether a person having special skill or competence has breached the standard of reasonable care, the appropriate benchmark is the level of care that would be expected of an ordinary and competent practitioner practising in that field and having the same level of expertise.

76 This means that factors such as the size, resourcing, degree of specialisation and the client base of the practitioner are relevant indicators of what represents a standard of reasonable care appropriate to the practitioner's professional peers. For example, what constitutes reasonable care in the case of a statement made by an accountant in a small general practice in Gizo is measured against the standard of care applicable to a reasonable and competent accountant in a practice that has these characteristics rather than a large accounting firm in Honiara.

**New entrants to tax system**

77 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 o r 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.

**Understanding of tax laws**

78 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.

79 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. The type of enquiry or request for advice that is appropriate will depend on the circumstances. For example, 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.

80 Where a person makes a genuine effort equal with their ability to research and support the position taken, this will be an indicator in favour of the exercise of reasonable care. Even if a person adopts a tax treatment that is inconsistent with the Commissioner's view, reasonable care will still be shown where a genuine effort is made to research the issue and there is a basis for the position taken.

81 In contrast, an interpretative position that is frivolous (not serious) indicates a lack of reasonable care because it is likely to be consistent with making little or no effort to exercise sound judgment. The Commissioner considers that frivolous means something that is not worth serious attention.

**Applying for a private ruling**

82 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. For 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**

83 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 conclusive evidence of a lack of reasonable care.

84 Each situation will involve a unique mix of circumstances that requires an enquiry about whether reasonable care is shown or is lacking. 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:

(a) regular internal audits;

(b) sample checking;

(c) providing adequate staff training; and

(d) preparing instruction manuals for staff.

85 What is appropriate and adequate for one business will not necessarily be sufficient for a different business. Factors such as the nature and size of the business will clearly be influential in determining what is sufficient in any given case.

86 The reasonable care standard does not require a person to guard against every possible shortfall amount. If a person's accounting systems and internal controls are appropriately designed and monitored to ensure that the likelihood of error is reduced to an acceptable level, this will be consistent with taking reasonable care.

87 However, whilst the possibility of human error cannot be eliminated, if a systemic error is detected and no steps are taken to rectify the problem, this will be a strong indicator that reasonable care has not been taken.

88 Following general industry or business practice is likely to be consistent with taking reasonable care because it will indicate what other businesses in the same or similar circumstances considered appropriate to cover off a foreseeable risk. Likewise, failure to adopt accepted practice indicates a lack of reasonable care because it suggests that the business did not do what others in the same or similar circumstances thought was proper and reasonable.

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

89 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. Where, for example, a person returns interest income based on incorrect information provided by the 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.

**Tax agents relying on third party information**

90 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.

91 Meeting this standard requires no more than acting in a way that does not

breach the common law duty of care owed to the client. Conduct consistent with discharging that duty of care necessarily means that reasonable care is demonstrated.

92 However, 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 plaintiffs 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.

93 These principles are also relevant in determining whether reasonable care has been taken by a tax agent who makes a statement on behalf of a client. If the facts are such that it produced an understatement of tax, there would have been a liability to penalty for failing to take reasonable care. This is because a reasonable accountant of ordinary professional competence would not have placed complete reliance on the accounts prepared by an unqualified bookkeeper.

94 On the other hand, a tax agent who relies on information prepared by an expert will have taken reasonable care unless they should reasonably have known that the information was incorrect. For example, a real property valuation prepared by a qualified valuer or an estimate of historical building cost made by a quantity surveyor are matters that are likely to be outside the range of professional expertise of a tax agent. Relying in good faith on advice of this nature is consistent with the taking of reasonable care even though the advice later proves to be deficient.

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

95 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.

96 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. For 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.

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

97 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. 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 misjudgment 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/ RECKLESSNESS

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

98 Whilst the offence is gross carelessness in taking a tax position, 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. The scheme of the uniform penalties regime is to impose the higher penalty in response to conduct that goes beyond mere carelessness or inadvertence by displaying a high degree of carelessness, namely gross. Where gross means great, such that it is a conscious decision of carelessness.

99 Like the test for determining whether reasonable care has been shown, 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.

100 Behaviour will indicate gross carelessness where it falls significantly short of the standard of care expected of a reasonable person in the same circumstances as the person. Although the test for determining whether gross carelessness is shown is the same as that applied for testing a lack of reasonable care, it is the extent or degree to which the conduct of the person falls below that required of a reasonable person that highlights a finding of gross carelessness.

101 Recklessness assumes that the behaviour in question shows disregard of or indifference to a risk that is foreseeable by a reasonable person. The Courts have said that: “Recklessness in this context means to include in a tax statement material upon which the Act or regulations are to operate, knowing that there is a real, as opposed to a very unlikely risk that the material may be incorrect, or be grossly indifferent as to whether or not the material is true and correct, and a reasonable person in the position of the statement-maker would see there was a real risk that the Act and regulations may not operate correctly to lead to the assessment of the proper tax payable because of the content of the tax statement. So understood the conduct is more than mere negligence and must amount to gross carelessness.”

102 Recklessness is gross carelessness - the doing of something which in fact involves a risk, whether the doer realises it or not; and the risk being such having regard to all the circumstances, that the taking of that risk would be described as

'reckless'. The likelihood or otherwise that damage will follow is one element to be considered, not whether the doer of the act actually realised the likelihood. The extent of the damage which is likely to follow is another element.

103 The degree of the risk and the gravity of the consequences need to be weighed in forming a conclusion about whether conduct is reckless. If the risk is slight and the damage which will follow if things go wrong is small, it may not be reckless, however unjustified the doing of the act may be. If the risk is great, and the probable damage great, recklessness may readily be a fair description, however much the doer may regard the action as justified and reasonable. Each case has to be viewed on its own particular facts and not by reference to any formula.

**Gross Carelessness Recklessness**

104 The Courts in Australia have long recognised that the ordinary meaning of recklessness involves something more than mere inadvertence or carelessness. 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.

105 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.

106 A finding of dishonesty is not essential to a finding of recklessness. It is sufficient that the person's behaviour objectively displayed a high degree of carelessness and indifference to the consequences.

107 In some circumstances, an incorrect estimate may be due to reckless behaviour of the person. For example, in the context of making a reasonable estimate of its turnover, an estimate will be considered to have been made recklessly where the person fails to consider most of the relevant factors that are likely to materially

affect its estimate of the turnover.

**Intentional Disregard of a tax law**

**Meaning of intentional disregard of a tax law**

108 Section 122 provides that a person is liable to pay the prescribed penalty if:

(a) the taxpayer takes a tax position that is not a reasonably arguable position in disregard of a clear obligation under a tax law; and

(b) the taxpayer does so with the dominant intention of reducing or removing a tax liability or obtaining a tax benefit; and

(c) the tax position results in a tax shortfall.

109 The adjective 'intentional' means that something more than reckless disregard of or indifference to a tax law is required.

110 Unlike the objective test which applies to determine whether there has been a want of reasonable care or recklessness, the test for intentional disregard is purely subjective in nature. The actual intention of the taxpayer is a critical element.

111 Intentional disregard means that there must be actual knowledge that the statement made is false. To establish intentional disregard, 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.

112 Dishonesty is a requisite feature of behaviour that shows an intentional disregard for the operation of the law. This is another significant difference between this type of behaviour and behaviour that shows a lack of reasonable care or recklessness where dishonesty is not an element.

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

114 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.

115 Intentional disregard of the law can be inferred from the facts and surrounding circumstances. Intentional disregard is also more than just disregard for the consequences or reckless disregard. The facts must show that a person consciously decided to disregard clear obligations under a tax law, of which the person was aware. For example, the production of false records will amount to an intentional disregard of a tax law.

116 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. 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.

117 Intentional disregard of a tax law or regulations may be determined on the basis of direct evidence, or by inference from the surrounding circumstances.

**Assessment of administrative penalty**

118 Under section 123 of the Act the Commissioner may impose an administrative penalty in accordance with the section and in doing so, must not impose an administrative penalty that exceeds the prescribed maximum penalty amount for the administrative penalty

119 The Minister has prescribed maximum penalties for the administrative penalties in the Tax Administration Regulations 2022 Gazetted on 1st November 2022. Attached at Appendix 2 is an extract of Legal Notice No. 257 Regulation 11.

120 In view of the fact that the maximum penalty is the same for each type of behaviour, the Commissioner will in making an assessment imposing an administrative penalty under section 123 of the Act adopt an approach to the penalties based on culpability and not charge the maximum penalty in every case.

121 Rather, the Commissioner will take into account the seriousness of the behaviour. (See PR 2024/4)

**Remission of administrative penalty**

122 The Act provides in section 124 that the Commissioner may remit part or all of an administrative penalty imposed under section 123 either on:

(a) the Commissioner's own initiative; or

(b) the application in writing of the person assessed for the penalty under section 123.

123 The grounds for a remission of the penalty are set out in section 124 as the following:

(a) serious hardship to the person subject to the penalty, such as financial misfortune, health or impacts of natural disaster;

(b) the incorrect imposition or calculation of a penalty;

(c) circumstances that the person subject to the penalty cannot change or influence, such as such as serious illness or absence from the country;

(d) an honest unintentional failure to pay unpaid tax by the person subject to the penalty, such as being unaware of the tax owing because the person did not receive the notice;

(e) any other prescribed ground.

*(See PR 2024/4 for examples of when the Commissioner will remit Administrative penalty)*

**DATE OF EFFECT**

124 This Ruling applies to years of income commencing both before and after its date of issue. This 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 final Ruling.

Dated this thirty-first day of May 2024.

**JOSEPH DOKEKANA**
COMMISSIONER INLAND REVENUE

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## APPENDIX 1

## EXAMPLES

| No | Example | Application of Ruling |
|---|---|---|
| **Statement of fact and Law** | | |
| 1 | Solomon Trading Company has claimed a deduction in its return that is not in the accounts that it says qualifies as a deduction. | Solomon Trading Company has made a statement of mixed fact and law because it claimed it had incurred expenditure (an alleged fact) and that it is entitled to a deduction for that expenditure (to be decided under law). |
| **False or misleading in a material particular** | | |
| 2 | Paul, a sole trader, claimed a claimed a deduction for car expenses based on a faulty odometer. Apart from this error he had kept an accurate logbook of all travel. | The claim is an incorrect statement, even if he was unaware that the odometer was faulty. It is in a material particular" if the deduction is substantial and Paul received a much higher deduction than he was entitled to, say 10% more. |
| 3 | JKK (SI) TradingLb td requested an amendment to its income tax assessment to claim a deduction for sponsorship. In its request it failed to disclose that advantage (upgrade to business class) a material advantage (upgrade to business class) accrued to the managing Director in return for making the sponsorship. | The taxpayer has made a false statement even though it actually made the payment. The taxpayer failed to disclose a material fact which would affect its entitlement to deduction. An amount paid does not meet the definition of sponsorship if some benefit is received for the payment. |
| 4 | Company X understated in its return the amount of gross interest it derived for the year. The omossion of an amount of interest resulted in the company's taxable income being understated for the income year. | The understatement of gross interest is a material particular because it reduced the amount of income tax that was assessed to be payable. |
| **Person who made the statement did not know and could not reasonably be expected to know that the statement was false or misleading in a material particular.** | | |
| 5 | Stephen is a 54-year-old farmer who always prepares his own income tax return. A few months prior to lodging his last return he suffered a stroke. In the period of his rehabilitation, he was unable to attend to any paperwork or correspondence. During that period, he misplaced one of several interest statements sent to him by his bank. At the time of preparing his return Stephen was still catching upon the backlog of paperwork and had still not fully recovered. As a result, he returned interest of $49,750 rather than the correct amount of $50,000. | Stephen's illness and incapacity are relevant factors for determining whether he had knowledge or could reasonably be expected to have knowledge. So too are the facts that one of many bank statements was misplaced and the amount of the understated interest was relatively small in comparison to the total interest derived, such that the amount actually returned did not. seem unusually small. It is likely that a reasonable person in Stephen's circumstances who was making a genuine effort to comply with his or her tax obligations could have omitted the amount. As a result, Stephen could be considered to not have knowledge or not be reasonably expected to have knowledge that the statement was false or misleading in a material particular. |

| | | |
|---|---|---|
| 6 | Alistair is a 60-year-old farmer who manages his own tax affairs. For the past eighteen months, he has been busy with his business and voluntary community work and has not given much attention to his own paperwork. As a result, he misplaced one of two interest statements sent to him by his bank for the last income year. At the time of preparing his income tax return, Alistair did not check his interest statements for the year. As a result, he returned interest of $6 000 rather than the correct amount of $12,000. | Alistair's busy schedule is not a factor which can help to establish he has knowledge or could reasonably be expected to have knowledge that the statement was not false or misleading in a material particular, because generally a reasonable person would organise their business and private obligations so sufficient time and effort can be devoted to their tax affairs. His age is also an irrelevant factor, because it does not impede his ability to conduct his daily affairs. The fact that Alistair misplaced one of only two statements and omitted half of his interest income is relevant because it is likely that a reasonable person in Alistair's circumstances would have noticed that one statement was missing and a substantial amount of the total interest had been omitted. As a result, Alistair would be considered to have knowledge or reasonably expected to have that knowledge that the statement was false or misleading in a material particular. |
| 7 | Company XYZ (SI) operates a small business. In its return for the last income year the company disclosed assessable income of $500,000. However, an administrative error resulted in $100,000 of assessable income being omitted. | It is reasonable to conclude that the company should have been aware that all its income had not been returned given the relatively large amount that was omitted. This is regardless of whether or not the person used an agent to complete the return. In the absence of other factors which indicate that the person does not have knowledge or reasonably expected to have that knowledge (for example, adequate procedures in place which were reasonably designed to prevent such errors from occurring) the person would be considered to have knowledge or reasonably expected to have that knowledge in this case that the statement was false or misleading in a material particular. |
| 8 | Company SI Ltd returns assessable income of $50,000,000 for the last income year but omits assessable income of $100,000. | Subject to consideration of the circumstances that led to the error, the relative size of the omission does not, of itself, support a conclusion that the company is considered to have knowledge or reasonably expected to have that knowledge that the statement was false or misleading in a material particular. The size of the error in relation to them total assessable income (0.02% of assessable income) may mean that the company, despite the error, still is not be considered to have knowledge or reasonably expected to have that knowledge that the statement was false or misleading in a material particular in the preparation of its tax return. |
| 9 | An employee of a small business makes an error of $10,000 in transferring figures from working papers to the Goods Tax return. The owner of the business was aware that the same employee had made a number of similar transposition errors in previous Goods Tax returns, but the owner took no action. | In this case it could be concluded that a reasonable person in the business owner's circumstances would have foreseen a risk and put simple checks in place that would at least reduce the risk of obvious errors. Therefore, in respect of the shortfall which resulted from the $10, 000 error, the person would be liable for false and misleading statement penalty as they could be considered to have knowledge or reasonably expected to have that knowledge in making a statement that was false or misleading in a material particular. |
| **Reporting Tax Obligations** | | |
| 10 | Mrs. and Mr. H are both public Mrs. H servants who earn $67,000 and $35,000 respectively. They own a rental property as joint tenants and are not carrying on a rental property business. Their tenant did not deduct withholding tax. So, Mrs. H for the year of income ended 30 June 2022 prepared an individual return and the property returned a rental loss of $2,000. This loss was claimed in full by Mrs. H who prepared her own return but did not read any instructions. Her only reason for claiming the whole of the loss was that she was not aware that she could not personally claim the entire loss, and that the overall tax outcome was more favourable if the loss was claimed by the person in the higher tax bracket. | Mrs H. may be considered to have knowledge or reasonably expected to have that knowledge because a reasonable person in her circumstances would have read instructions. |

| | | |
|---|---|---|
| **Using an Agent** | | |
| 11 | would have noticed that one statement was missing and a substantial amount of the total interest had been omitted. As a result, Alistair would be considered to have knowledge or reasonably expected to have that knowledge that the statement was false or misleading in a material particular. | A competent registered tax agent with this knowledge would have characterised the expense as a capital improvement and claimed a wear and tear deduction rather than an outright deduction. Although the agent made the false claim the taxpayer is still penalised. |
| 12 | John engaged a registered tax agent to prepare his income tax return for the previous income year. In discussions prior to preparing the return John informed the registered tax agent that a building he owed had been sold during the year of income. The agent does not ask John whether the building had ever been used for income producing purposes and does not include the amount of the sale price above the written down value in John's assessable income. | A registered tax agent exercising reasonable knowledge would have asked for this additional information. Although the agent made the false claim the taxpayer is still penalised. |
| **Circumstance of ill health - reasonable care taken** | | |
| 13 | Helen has been diagnosed with cancer and has had emergency surgery and intensive chemotherapy treatment. In preparing her tax return she overlooked a relatively small amount of interest earned on one of her investment accounts. While recovering from surgery and during her treatment she misplaced the relevant statement from the financial institution. | It is a reasonable conclusion that Helen's illness has contributed to her failure to correctly record interest earned during the income year. An appropriate conclusion is that a reasonable person in the same circumstances might not be as thorough or as organised in keeping records as a person who was not dealing with significant health issues. Taking her personal circumstances into account it is reasonable to conclude that Helen has exercised reasonable care. |
| **Personal circumstances do not support reason able care** | | |
| 14 | Richard is a professional musician. Because of his touring commitments he has spent roughly one week in every four away from home. When not on tour, he has had a full schedule of rehearsals and has also been making arrangements for his wedding. He has not had time to organise his tax records and has overlooked interest of $10,000 earned on one of his investment accounts. He explains that he forgot to include the interest because he had been too busy to devote time to organising his tax records and had misplaced the particular statement from the financial institution. | Although Richard has a busy professional and personal life, these are not special circumstances that warrant the application of a lower standard of care in meeting his tax obligations. These circumstances do not impair or compromise his capacity to comply with his taxation obligations. A reasonable person in Richard's circumstances would be expected to devote sufficient time to record keeping so assessable income is accurately returned. |
| **Frivolous interpretative position - reason able care not shown** | | |
| 15 | Felix, a businessperson who is registered for Sales Tax, buys a restaurant. He sells beer for takeaway from his premises. He is uncertain about whether he should charge sales tax on the beer sales and asks his nephew who is a second-year law student for advice. Based on the advice he does not charge sales tax. | Felix has not acted reasonably in relying on the advice of an unqualified person. Had he checked with Inland Revenue or consulted Inland Revenue publications he would have been informed that sales tax is chargeable on restaurant services as defined. |
| **Small business - record keeping reasonable care shown** | | |
| 16 | Mabel and Fergus run a fish and chip stall in Kukum. They are registered Sales Tax and keep basic accounts for the business from which hey prepare their monthly Sales Tax returns. Mabel prepares the return which is later checked by Fergus. During an Inland Revenue audit a minor shortfall amount is identified for a tax period. The discrepancy is due to a transposition error. | Mabel and Fergus have exercised reasonable care because the record for keeping system and procedures for a checking the accuracy of their Sales Tax returns are appropriate and adequate given the size and nature of their business operations. |

| | | |
|---|---|---|
| **Large business - record keeping reasonable care not shown** | | |
| 17 | An employee of a large manufacturing company makes an error of $100,000 in transferring figures from the accounts to a Goods Tax return. The chief accountant is aware that this employee has made similar transposition errors in preparing previous Goods Tax returns. Despite this knowledge, no steps were taken to put checks in place that would guard against the repetition of such a mistake. | The failure to implement appropriate procedures means that the company has not exercised reasonable care. This example also highlights that 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 reasonable care 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 person employer must act through agents and employees as it is incapable of acting otherwise. |
| **Relying on third party information - failure to take reasonable care** | | |
| 18 | Felicity owns a small dress shop, and she has a bookkeeper to prepare monthly statements of sales and outgoings and the bookkeeper deposits the net proceeds into Felicity's bank account. One statement has a typographical error which shows a net amount of $1,000 instead of the correct amount of $ 10,000. The correct amount has been deposited into the account. | Felicity did not check the statement and includes the incorrect monthly amount when she works out her sales income. A reasonable person would have had grounds to suspect that the amount recorded on the statement was wrong because it was significantly less than the other monthly statements. This could have been verified by cross-checking the statement against the bank statement. A reasonable person in the same circumstances would have been more diligent than Felicity in ensuring that the correct amount of sales income was returned. Felicity has failed to exercise reasonable care. |
| **Relatively large shortfall amount - reasonable care not shown** | | |
| 19 | During the income year Atticus had two separate types of income: • dividends; and • employment income. When he prepares his tax return, he shows the $40,000 income from the employment income but forgets to include the $14,000 from dividends received. | Given that the amount of the omission represents 25% of Atticus's total assessable income, it would be expected that a reasonable person would not have forgotten to return the income. The omission is also obvious because a reasonable person would have been prompted to query that dividends are income. Atticus has not exercised reasonable care. |
| **Relatively small shortfall amount - reasonable care shown** | | |
| 20 | A large company returns assessable income of $4 million but because of a single transposition error it omits an additional $20,000. The omission was caused by inadvertent human error and not by a failure in the reporting systems or procedures. | In contrast to example 19, the amount of the omission represents 1% of assessable income a very small proportion of the total assessable income. In these circumstances and given the relative size of the omission, the company has acted with reasonable care despite the error. If it was $200,000 5% of assessable income, reasonable care would not be shown. |
| **Gross Carelessness/Recklessness** | | |
| 21 | Company XYZ (SI) which carries on a small business, was subject to a record keeping audit. At the end of the audit Inland Revenue advised the company about the areas where the records were inadequate and what was required to remedy the situation. The company was advised that it was likely that the correct amount of taxable income would be returned if the suggested improvements of IRD to the company's record-keeping practices were implemented in full. Rather than following the advice, the business made minor changes to heir record-keeping system which did not improve the adequacy of their records. | Two years later the business was subject to an income tax audit. A shortfall amount was detected which was caused by inadequate record keeping. The facts indicate that the shortfall amount was caused by the company's gross carelessness. |
| **Intentional disregard of a tax law** | | |
| 22 | Company XYZ, in preparing its tax return, failed to include interest earned on funds held in an account that was opened in a false name. | It can be inferred that the company acted intentionally in omitting the interest from its return. It is also a possible fraud case. |

| | | |
|---|---|---|
| 23 | Pauline is not certain whether an amount she received during the year is assessable income and therefore chose not to include that amount in her income tax return. She did not take any steps to ascertain if the amount was assessable, such as making enquiries with IRD. | In failing to include the amount, she has not intentionally disregarded a tax law. However, the action may constitute failure to exercise reasonable care or recklessness. |
| 24 | Peter, an accountant, receives payment for his services by way of cash, cheque and credit. In his Sales Tax return, Peter reports a Sales Tax net amount on the basis that the Sales Tax payable is calculated on the credit card and cheque receipts only, and not the cash transactions. | In the absence of a reasonable explanation for the omission it can be inferred that Peter has acted intentionally in omitting to calculate Sales Tax on services for which cash was received. As a professional person, this behaviour amounts to willful deceit and deception and is more than intentional disregard. Omission of all cash receipts is tax evasion. |

## APPENDIX 2

Maximum prescribed penalties for administrative penalties

(1) The maximum prescribed penalty that may be imposed for an administrative penalty for breach of the section of the Act specified in Column 1 of the Table is specified in Column 3 of the Table.

(2) The maximum prescribed penalty that may be imposed for an administrative penalty for each day that the breach of the section of the Act specified in Column 1 of the Table continues is specified in Column 4 of the Table.

## TABLE

## MAXIMUM PRESCRIBED PENALTIES

| **Column 1 section breached** | **Column 2 Description of breach** | **Column 3 Maximum administration penalty for breach** | **Column 4 Additional maximum administrative penalty for continuing breach** |
|---|---|---|---|
| 114 | Failure to keep maintain records and | 10,000 penalty units | 20 penalty units for each day that the breach continues |
| 115 | Failure to apply for TIN | 5,000 penalty units | 20 penalty units for each day that breach continues |
| 116 | Failure to update TIN information | 5,000 penalty units | 20 penalty units for each day that breach continues |
| 117 | Failure to display tax agent certificate | 5,000 penalty units | NIL |
| 118 | Late filing | 5,000 penalty units | 20 penalty units for each day that breach continues |
| 119 | False or misleading statement | 10,000 penalty units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |
| **Column 1 Section breached** | **Column 2 Description of breach** | **Column 3 Maximum administrative penalty for breach** | **Column 4 Additional maximum administrative penalty for continuing breach** |
| 120 | Failure to take reasonable care | 10,000 penalty units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |
| 121 | Gross carelessness | 10,000 penalty units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |

| | | | |
|---|---|---|---|
| 122 | Intentional disregard | 10,000 penalty units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |

***Note:*** *The Commissioner considers that only one "penalty" will apply, in situations of section 119 to 122 breaches, either the 10,000 penalty units or the shortfall amount "penalty". The penalty would be the shortfall amount where the shortfall amount is greater than the 10,000 penalty units. Otherwise, it would be the 10,000 penalty units.*

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## PUBLIC RULINGS
(section 149)

## PUBLIC RULING 2024/3

## MEANING OF, AND PENALTY FOR TAKING A TAX POSITION THAT IS NOT REASONABLY ARGUABLE



**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 administrated by the Commissioner.

7 Division 3 of Part 8 of the Act imposes penalties for:

(a) failure to keep and maintain the tax records required by a tax law;

(b) failure to apply for a TIN;

(c) failure to update TIN information;

(d) failure to display a tax agent certificate;

(e) late filing;

(f) false or misleading statement to a tax officer;

(g) failure to take reasonable care in taking a tax position;

(h) gross carelessness in taking a tax position;

(i) 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;

(e) 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) 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;

(b) 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) a taxation law;

(b) 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;

(c) a decision of a court (whether or not a Solomon Islands Court); and

(d) 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 in formation 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 2 date of issue of the Ruling.

Dated this thirty-first day of May 2024

**JOSEPH DOKEKANA**
COMMISSIONER

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## 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.

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## PUBLIC RULINGS
(section 149)

## PUBLIC RULING 2024/4

PR 2024/4 Commissioner's guidelines as to when he or she will reduce penalties from the maximum prescribed amount based on culpability and remission of administrative penalties



**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 provides guidelines on how the Commissioner's power in section 123 of the Act to impose administrative penalties may be exercised. In providing these guidelines, there is no intention to lay down conditions that may restrict the exercise of the Commissioner's discretion. Nor does the Ruling represent a general exercise of the Commissioner's discretion, but rather gives taxpayers and tax agents the principles that the Commissioner will apply in exercising his or her discretion. Also, the guidelines are provided to assist tax officers in determining when the discretion should be exercised and to help ensure that taxpayers receive consistent treatment.

#### Background

2 The administrative penalty regime contained in the Act applies from 1st January 2023 to all taxes administrated by the Commissioner, and delegated officers of the Inland Revenue Division (IRD) from time to time.

3 The regime sets out uniform administrative penalties that apply to persons that fail to satisfy certain obligations under the tax laws covered by the Act.

4 Division 3 of Part 8 of the Act imposes penalties for:

(a) failure to keep and maintain the tax records required by a tax law;

(b) failure to apply for a TIN;

(c) failure to update TIN information;

(d) failure to display a tax agent certificate;

(e) late filing;

(f) false or misleading statement to a tax officer;

(g) failure to take reasonable care in taking a tax position;

(h) gross carelessness in taking a tax position;

(g) 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.

5 This Ruling considers the assessment and remission of administrative penalties for those penalties where there are both penalty units and a tax shortfall imposed, namely:

(a) false or misleading statement to a tax officer;

(b) failure to take reasonable care in taking a tax position;

(c) gross carelessness in taking a tax position;

(d) taking a tax position in disregard of a clear tax law obligation with intent to reduce or remove a tax liability or to obtain a tax benefit.

## RULING

### Assessment of administrative penalty

6 Under section 123 of the Act the Commissioner may impose an administrative penalty in accordance with the section; and in doing so, must not impose an administrative penalty that exceeds the prescribed maximum penalty amount for the administrative penalty.

7 The Minister has prescribed maximum penalties for the administrative penalties in the Tax Administration Regulations 2022 gazetted on 1st November 2022. Attached at Appendix 1 is an extract of Legal Notice No. 257 Regulation 11.

8 In view of the fact that the maximum penalty is the same for each type of behaviour, the Commissioner will, in making an assessment imposing an administrative penalty under section 123 of the Act, adopt a graduated approach to reduction of the penalties based on culpability and not charge the maximum penalty in every case.

**Principles to consider in the reduction of penalties**

9 The decision to reduce the penalty may be made in the making of an assessment. The penalty will not be reduced where IRD considers the case warrants referral for criminal investigation and/or prosecution. Where payers are prosecuted, they cannot be made liable for an administrative penalty forthe same offence.

10 The decision to reduce the maximum penalty should:

(a) consider the merits of each case, the matters relevant to the penalty and not irrelevant matters;

(b) be made with just cause and not on the basis of random choice or personal impulse;

(c) be made in good faith; and

(d) consider the taxpayer's behaviour.

11 The factor of the seriousness of the taxpayer's behaviour and the number of occasions the behaviour has occurred are significant matters in the amount to remit as is the level of tax shortfall. Whilst the term "tax shortfall" is not defined in the TAA, the Commissioner considers a tax shortfall, for a return period, means the difference between the tax effect of -

(a) a taxpayer's tax position for the return period; and

(b) the correct tax position for that period,

when the taxpayer's tax position results in too little tax paid or payable by the taxpayer or another person or overstates a tax benefit, credit, or advantage of any type or description whatever by or benefitting (as the case may be) the taxpayer or another person.

12 The Commissioner's officers will consider reducing the following level of penalties from the maximum prescribed penalties based on culpability as in the table below:

| Behaviour of the taxpayer | Level of reduction from maximum Penalty amount | Assessment of Penalty amount |
|---|---|---|
| **Worst type of behaviour** A taxpayer's behaviour is deliberate or involves fraud for any tax shortfall amount, or organised crime, or threatening an IRD officer or offering an IRD officer a bribe. | 0% | 100% |
| Behaviour of the taxpayer | Level of reduction from maximum Penalty amount | Assessment of Penalty amount |

| | | |
|---|---|---|
| **Highest level of behaviour which breaches the tax law**<br><br>A taxpayer knowingly decides to take a tax position that is not a reasonably arguable position in disregard of a clear obligation under a tax law.<br><br>And the tax shortfall is greater than $100,000 or 20% of the tax payable for the tax year on the basis of the taxpayer's tax return, whichever is the greater. | 25% | 75% |
| **Medium level of behaviour**<br>A taxpayer's actions demonstrate gross carelessness, showing a disregard or indifference to their obligations or a taxpayer makes a false and misleading statement. | 50% | 50% |
| **Least serious level of behaviour**<br>A taxpayer fails to exercise the care that a reasonable, ordinary person would exercise to fulfil the taxpayer's tax obligations | 75% | 25% |
| **Voluntary disclosure**<br>On their own initiative, before being told of anticipated audit action, a taxpayer brings their failure to withhold or a tax shortfall to the attention of IRD | 100% | Nil |
| **Note**: repeated types of behaviour may indicate the taxpayer is being careless. If so, this level of remission will not apply. Where a shortfall amount occurs that is greater than $100,000 or 20% of the tax properly payable for the tax year on the basis of the taxpayer's tax return, no level of reduction from maximum penalty amount will apply | | |

13 The Commissioner may not reduce the penalty by the above percentage if there are other factors warranting further increase or decrease of the penalty amount.

14 An officer may decrease the level of reduction if there are aggravating factors such as where the taxpayer:

(a) has taken steps to prevent or hinder IRD from finding out about the tax shortfall; or

(b) has been penalised in a previous period for a tax shortfall and there has been no improvement in their compliance.

15 IRD may increase the level of reduction if there are mitigating factors such as where the taxpayer:

(a) tells IRD of the tax shortfall after IRD has advised of an intention to conduct an audit, and

(b) the officer estimates the disclosure is likely to have saved IRD a significant amount of time or resources in the conduct of the audit.

**Remission of administrative penalty**

16 The Act provides in section 124 that the Commissioner may remit part or all of an administrative penalty imposed under section 123 either on:

(a) on the Commissioner's own initiative; or

(b) on the application in writing of the person assessed for the penalty under

section 123.

17 The grounds for a remission of the penalty are set out in section 124 and summarised in the following table below:

| | Ground for remission | Example |
|---|---|---|
| (a) | serious hardship to the person subject to the penalty, | Serious hardship includes financial misfortune, health or impacts of natural disaster or riots. (See PR 2024/5) |
| (b) | the incorrect imposition or calculation of a penalty; | An incorrect imposition would be where a taxpayer had lodged a return on time but as a result of an Inland Revenue mistake, a penalty was imposed.<br>An incorrect calculation would be where the start date of the penalty calculation was recorded incorrectly. |
| (c) | circumstances that the person subject to the penalty cannot change or influence | Circumstances that a person cannot change or influence include serious illness or absence from the country as well where it is impractical or uneconomic to collect the penalty such as the circumstances outlined in section 68 of the Act. (See PR 2024/5); |
| (d) | an honest unintentional failure to pay unpaid tax by the person subject to the penalty, | an honest unintentional failure to pay unpaid tax includes being unaware of the tax owing because the person did not receive any notice; |
| (e) | any other prescribed ground | At present the Minister has not prescribed any other grounds. |

## DATE OF EFFECT

18 This Ruling applies to years of income commencing both before and after its date of issue. This 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 final Ruling.

**JOSEPH DOKEKANA**
COMMISSIONER

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## APPENDIX 1

19 Maximum prescribed penalties for administrative penalties

(1) The maximum prescribed penalty that may be imposed for an administrative penalty for breach of the section of the Act specified in Column 1 of the Table is specified in Column 3 of the Table.

(2) The maximum prescribed penalty that may be imposed for an administrative penalty for each day that the breach of the section of the Act specified in Column 1 of the Table continues is specified in Column 4 of the Table.

### TABLE

### MAXIMUM PRESCRIBED PENALTIES

| Column 1 Section breached | Column 2 Description of breach | Column 3 Maximum administrative penalty for breach | Column 4 Additional maximum administrative penalty for continuing breach |
|---|---|---|---|

| | | | |
|---|---|---|---|
| 114 | Failure to keep and maintain records | 10,000 penalty units | 20 penalty units for each day that the breach continues |
| 115 | Failure to apply for TIN | 5,000 penalty units | 20 penalty units for each day that breach continues |
| 116 | Failure to update TIN information | 5,000 penalty units | 20 penalty units for each day that breach continues |
| 117 | Failure to display tax agent certificate | 5,000 penalty units | NIL |
| 118 | Late filing | 5,000 penalty units | 20 penalty units for each day that breach continues |
| 119 | False or misleading statement | 10,000 penalty units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |
| 120 | Failure to take reasonable care | 10,000 penalty units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |
| 121 | Gross carelessness | 10,000 penalty units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |
| 122 | Intentional | 10,000 penalty disregard units or (if a tax shortfall occurs) the amount of the shortfall, whichever is higher | NIL |

***Note**: The Commissioner considers that only one "penalty" will apply, in situations of section 119 to122 breaches, either the 1 0,000 penalty units or the shortfall amount "penalty". The penalty would be the shortfall amount where the shortfall amount is greater than the 1 0,000 penalty units. Otherwise, it would be the 10,000 penalty units.*

On 1 January 2023 a penalty unit was equal to $1.00, under section 50A of the Interpretation and General Provisions Act Cap 85, but this amount is expected to increase in future.

## APPENDIX 2

20 Examples

| No | Example | Application of Ruling |
|---|---|---|
| 1 | Taxpayer A does not use a cash register she has in her store. She does not issue receipts and puts cash in a drawer. When the time comes to lodge her tax return, she only declares 50% of the sales made | This type of behaviour is deliberate and involves fraud. There are no mitigating factors and no reason not to impose the maximum penalty amount. |
| 2 | Taxpayer B uses the cash register in his business. He does not make sure that staff put all sales through the cash register and does not keep records of all sales. At the end of an audit, Inland Revenue advised Taxpayer B about the areas where the records were inadequate and what was required to remedy the situation. The taxpayer was advised that it was likely that the correct amount of taxable income would be returned if the suggested improvements of IRD to his record-keeping practices were implemented in full. Rather than following the advice, the taxpayer made minor changes to their record keeping system which did not improve the adequacy of his records. Two years later, taxpayer B was subject to an income tax audit. A shortfall amount was detected which was caused by inadequate record keeping | The facts indicate that the shortfall amount was caused by Taxpayer B's recklessness which displays a medium level of behaviour and warrants a medium level of penalty. |

| | | |
|---|---|---|
| 3 | Taxpayer C uses her cash register every day to deposit all sales cash and EFT-POS. On one day, the cash register breaks down and some 10 sales totaling $1 ,000 are not recorded and Taxpayer C forgets to tell her tax agent when the tax return is being prepared. | This type of behaviour is not deliberate and there is a mitigating factor to not impose the maximum penalty amount. It displays the least level of behaviour and warrants only a minimum level of penalty. |

## PUBLIC RULINGS

(section 149)

## PUBLIC RULING 2024/5

## COMMISSIONER'S GUIDELINES FOR WRITE OFF OF TAX DEBT AND REMISSION AND REFUND OF TAX



**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 provides the Commissioner's guidelines on how the discretion in sections 67 and 68 of the Act may be exercised. In providing these guidelines, there is no intention to lay down conditions that may restrict the exercise of the Commissioner's discretion. Nor does the Ruling represent a general exercise of the Commissioner's discretion. Rather, the guidelines are provided to assist tax officers in determining when the discretion should be exercised and to help ensure that taxpayers receive consistent treatment. The guidelines also inform taxpayers of the principles that tax officers will apply in considering the exercise of the discretion.

**Class of person/arrangement or transaction**

2 This Ruling applies to a taxpayer who has made a request for remission of a tax debt under section 67 of the Act or where the Commissioner exercises his discretion to write off tax under section 68 of the Act.

**RULING**

**Legislative framework**

3 Section 67 of the Act provides that a taxpayer, who is a natural person, may apply in writing to the Commissioner to remit or refund some or all:

(a) tax payable by the taxpayer; or

(b) tax paid in the financial year in which the request is made on the ground of serious hardship to the taxpayer.

4 The Commissioner must:

(a) serve the taxpayer with a written notice of the decision of the Commissioner; and

(b) if the decision is to remit or refund:

(i) remit by issuing an amended tax assessment; or

(ii) refund by paying the taxpayer the amount refunded (but interest is not payable on the amount refunded).

5 The Commissioner may reverse a remission or refund of tax if the remission or refund was made on the basis of false or misleading information provided by the taxpayer.

6 The Commissioner must not remit or refund tax unless the Commissioner is satisfied that the tax has not been passed on by the taxpayer to another person.

Section 68 of the Act provides that the Commissioner may write off tax payable under a tax law if the Commissioner determines that collection of the tax:

(a) is uneconomic; or

(b) is impractical; or

(c) in the case of a taxpayer who is a natural person, would cause that person serious hardship.

8 It should be noted that the Commissioner has the power to write off tax debt in his own right where it is apparent that serious hardship exists as there is no provision in this section which requires a taxpayer to apply for write off. However, where serious hardship is a matter of personal circumstances, the taxpayer must apply in writing and provide evidence.

9 The Act provides that the circumstances in which the Commissioner may determine that the collection of tax is uneconomic, is impractical or would cause

serious hardship as including the following:

| | Circumstance | Write off reason |
|---|---|---|
| (a) | The taxpayer is dead and the taxpayer's estate has been distributed | Impractical/Uneconomic |
| (b) | The taxpayer is bankrupt | Impractical |
| (c) | The taxpayer has been liquidated | Impractical |
| (d) | The taxpayer has been removed from the register of companies because it is no longer in existence or otherwise dissolved | Impractical |
| (e) | The taxpayer is seriously ill or incapacitated | Impractical/would cause serious hardship |
| (f) | The taxpayer is serving a term of imprisonment | Impractical imprisonment |
| (g) | The taxpayer is unable to be located or | Impractical resides overseas. |
| (h) | The taxpayer's debt is greater than the 7 year statutory record keeping period and the Commissioner has not attempted to recover the debt | Impractical/Uneconomic |
| (i) | The taxpayer never having had a requirement to file a tax return or other document under a tax law; | Incorrect imposition of tax. |

10 The definition of "**uneconomic**" is not provided by the Act. The Commissioner takes the view 'uneconomic' means that the cost of recovering the debt is estimated to be more than the value of the debt. In estimating the potential recovery costs, the Commissioner will take into account the value of salaries of tax officers, other Inland Revenue resources, resources of other government agencies, costs of engaging external legal experts and other experts, travel, communications and any other relevant expense.

11 The definition of "**impractica**l " is not provided by the Act. The Commissioner takes the view that 'impractical' refers to circumstances where, irrespective of whether the debt is uneconomic or not, it is not possible to collect the debt. For example, if the taxpayer cannot be located, and some years have passed, it would be impractical to pursue the debt. If the taxpayer is permanently overseas, and they can be contacted but are unwilling to pay the debt, it would be impractical to pursue the debt as the taxpayer is outside the Solomon Islands legal jurisdiction.

12 The Act also provides that. in any case where the Commissioner writes off tax in a circumstance set out in paragraph 9(a) to (c) above, the Commissioner may reinstate all or part of the tax written off if:

(a) additional funds due to the taxpayer's estate are discovered after the taxpayer's estate has been distributed; or

(b) the Commissioner receives, by operation of law, additional funds in respect of the taxpayer after the taxpayer is judged bankrupt or is liquidated.

13 Further, the Commissioner may reverse a write off if the write off was made on the basis of false or misleading information provided by the taxpayer.

14 The Commissioner considers "**serious hardship**" includes the circumstances where the taxpayer is affected by serious illness or incapacitation, financial misfortune, the impacts of natural disasters or riots, or family tragedy. The

Commissioner considers a family tragedy would include a very sad event or situation, such as one involving death or suffering of a close relative.

15 Serious hardship also includes circumstances where a taxpayer is unable to provide the following for themselves, their family or dependents:

(a) Food and accommodation

(b) clothing

(c) medical treatment

(d) education

(e) other basic necessities.

16 The Commissioner may ask the taxpayer to provide recent evidence to support their claim of serious hardship. The evidence should support the taxpayer's claim of their current financial circumstances. Any documents the taxpayer provides should be dated within four weeks of supplying them.

17 Types of evidence can include the following:

(a) official eviction notice (not a warning of possible eviction due to rental arrears)

(b) pending disconnection of essential services, like water, electricity or gas (does not include mobile phone or internet bills)

(c) notice of impending legal action

(d) letter from a charitable organisation regarding loss of employment or inability to provide for basic necessities

(e) bank notice, for example, overdraft call or mortgaged property repossession

(f) overdue medical bills

(g) letter from a doctor verifying the inability to earn an income due to illness or caring for a sick family member

(h) final notice from school regarding payment of mandatory fees

(i) funeral expenses

(j) repossession notice of essential items, like a car or motorcycle.

18 In addition to the factors listed above, the taxpayer must also be able to demonstrate that they do not own any assets which can be sold to pay some or all of the tax debt.

## DATE OF EFFECT

19 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.

Dated this thirty-first of May 2024.

**JOSEPH DOKEKANA**
COMMISSIONER

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20 Examples

(a) Taxpayer A, a sole trader, suffers a serious stroke which means she is unable to run her business. They have a tax debt of $10,000. The taxpayer's only asset is her family home. The Commissioner would consider that the taxpayer is suffering from serious hardship and would write off the debt.

(b) Taxpayer B, a sole trader, is imprisoned for a period of 5 years. It is determined by the Commissioner that it is impractical to collect the outstanding tax owed by Taxpayer B of $5,000 and the Commissioner would write off the debt.

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**TAX ADMINISTRATION ACT 2022**
(No. 3 of 2022)

**PUBLIC RULINGS**

I, Joseph Dokekana, Commissioner of Inland Revenue, under section 150 of the Tax Administration Act 2022, make the following public rulings as set out in the Schedule:

**SCHEDULE**

**PUBLIC RULINGS**
(Section 149)

**PUBLIC RULING 2024/6**
*(Previously PR 2022/1)*

**INCOME TAX: OFFSET OF**

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act Cap 123.

**TAXPAYER PROTECTION**

2 This Ruling provides you with the following level of protection:

This Ruling sets out how a tax law applies in relation to a type of person or a type of arrangement.

You can rely on this Ruling (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement in this

Ruling turns out to be incorrect because of a Court decision and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

**TAXATION LAWS**

3 All legislative references to "the Act" are to the Income Tax Act CAP 123.

**ARRANGEMENT TO WHICH THIS RULING APPLIES**

4 This Ruling explains the order in which business license fees are offset against tax charged compared with other types of tax credits, such as provisional tax and withholding tax.

5 This Public Ruling was previously issued as PR 2022/1 and is being reissued following the introduction of the Tax Administration Act 2022.

6 The class of person this Ruling applies to is persons who pay business licence fees to Councils.

**HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT**

7 Section 41(1) of the Act allows any person carrying on business who has paid a licence fee to a Council for a year in respect of that business to set off the amount of such fee against so much of the tax charged on such person subject to certain conditions.

8 In order to claim the set off the person must:

(a) prove to the satisfaction of the Commissioner that he paid during any year a licence fee for that year in respect of that business to a Council; This is achieved by production of a stamped receipt from the Council.

(b) make the claim within the time allowed for furnishing a return under section 57 of the Act, or such further time as the Commissioner may allow.

9 If these conditions are satisfied, then the amount of such fee shall be set off for the purposes of collection against so much of the tax charged on such person for such year as is attributable to gains or profits derived from the carrying on of such business during such year.

10 This is subject to the proviso that, notwithstanding the provisions of section 90, such person shall not be entitled to any refund in the event of the amount to be set off exceeding such tax charged on him.

**Credit for business license fee**

11 When a person in business pays a license fee to a provincial council, they are considered to have paid tax to that council, and so get a credit in their income tax

assessment.

12 The person can deduct the fee paid against the tax payable in their income tax return, if the person has a record that they paid the fee and file their return by the due date (or the extended due date if IRD has allowed the person an extension of time to file).

13 A credit is allowed up to the amount of the tax payable but cannot result in a refund to the person.

**Tax deductibility**

14 A taxpayer is not allowed a deduction for business license fees which have been allowed as a tax credit.

15 If all or part of the business license fee is not allowed as a tax credit, that amount may be claimed as a tax deduction.

**The order in which fees are to be applied.**

16 Where a person is entitled to a credit for the license fee paid, as well as other credits, this Ruling provides the rules on the order in which credits are to be allowed against income tax payable.

17 As some credits can result in a refund, unlike the business license fee credit, this order may affect whether a taxpayer will receive a refund or not.

18 The Commissioner is of the view that credits should be applied against income tax payable in an assessment in the following order:

(a) provisional tax, withholding tax and other taxes that can be credited; then

(b) business licence fees.

19 This order is due to provisional tax being an estimate of actual future tax payable, withholding tax being required to be deducted by a payer at a fixed percentage, and the business license fee being a deemed pre-payment of income tax.

**DATE OF EFFECT**

20 This Ruling applies to years of income commencing both before and after its date of issue. This 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.

Dated this eighteenth-day February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**COMMENTARY**

1 This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Income Tax Act Cap 123 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

3 This Commentary explains the order in which business license fees are offset against tax charged compared with other types of tax credits, such as provisional tax and withholding tax.

**Summary**

4 Section 41(1) of the Act allows any person carrying on business who has paid a licence fee to a Council for a year in respect of that business to set off the amount of such fee against so much of the tax charged on such person subject to certain conditions.

5 In order to claim the set off the person must:

(a) prove to the satisfaction of the Commissioner that he paid during any year a licence fee for that year in respect of that business to a Council;

This is achieved by production of a stamped receipt from the Council.

(b) make the claim within the time allowed for furnishing a return under section 57 of the Act, or such further time as the Commissioner may allow.

6 If these conditions are satisfied, then the amount of such fee shall be set off for the purposes of collection against so much of the tax charged on such person for such year as is attributable to gains or profits derived from the carrying on of such business during such year.

7 This is subject to the proviso that provided that, notwithstanding the provisions of section 90, such person shall not be entitled to any refund in the event of the amount to be set off exceeding such tax charged on him.

**Credit for business license fee**

8 When a person in business pays a license fee to a provincial council, they are considered to have paid tax to that council, and so get a credit in their income tax assessment.

9 The person can deduct the business licence fee paid against the tax payable in their income tax return, if the person has:

(a) a record that they paid the fee; and

(b) filed their return by the due date (or the extended due date if IRD has allowed the person an extension of time to file).

10 A credit is allowed up to the amount of the tax payable but cannot result in a refund to the person.

**Tax deductibility**

11 A taxpayer is not allowed a deduction for business license fees which have been allowed as a tax credit.

12 If all or part of the business license fee is not allowed as a tax credit, that amount may be claimed as a tax deduction.

**The order in which business licence fees are to applied.**

13 Where a person is entitled to a credit for the business license fee paid, as well as other credits, this Ruling provides the rules on the order in which credits are to be allowed against income tax payable.

14 As some credits can result in a refund, unlike the business license fee credit, this order may affect whether a taxpayer will receive a refund or not.

15 The Commissioner is of the view that credits should be applied against income tax payable in an assessment in the following order:

(a) provisional tax, withholding tax and other taxes that can be credited; then

(b) business licence fees.

16 This order is due to provisional tax being an estimate of actual future tax payable, withholding tax being required to be deducted by a payer at a fixed percentage, and the business license fee being a deemed prepayment of income tax.

17 The Commissioner's view on the business license credit and the basis on which it is to be applied is set out below.

18 Section 41(1) of the Act allows any person carrying on business who has paid a licence fee to a Council for a year in respect of that business to set off the amount of such fee against so much of the tax charged on such person subject to certain conditions.

19 To claim the set off, the person must:

(a) prove to the satisfaction of the Commissioner that he paid during any year a licence fee for that year in respect of that business to a Council;

This is achieved by production of a stamped receipt from the Council.

(b) make the claim within the time allowed for furnishing a return under section 57 of the Act, or such further time as the Commissioner may allow.

20 If these conditions are satisfied, then the amount of such fee shall be set off for the purposes of collection against so much of the tax charged on such person for such year as is attributable to gains or profits derived from the carrying on of such business during such year.

21 This is subject to the proviso in section 41(1) that, notwithstanding the provisions of section 90, such person shall not be entitled to any refund in the event of the amount to be set off exceeding such tax charged on him.

**Entitlement to a refund**

22 However, a taxpayer will not be entitled to a refund if the amount to be set off exceeds the tax charged. This is because the section 41(1) proviso overrides section 90 in the case of refunds of Business Licence fees.

23 The Commissioner notes that sections 83(5) & (6) of the Act require a business to make prepayments of tax on the profits for each year in equal instalments (known as provisional tax). These payments will be credited against the tax chargeable. It should also be noted that provisional tax is not an actual tax but merely instalments of prepayment of income tax.

24 Section 90 provides for any overpayment of tax in excess of the amount chargeable to be refunded.

25 As the Income Tax Act does not provide an order in which credits for tax are to be offset, the Commissioner's view is that any amounts paid to IRD (e.g. provisional tax, Withholding Tax) should be offset against tax chargeable first with the business licence fee available to be offset against any tax payable that is remaining.

26 The purpose of offsetting in this order is that the provisional tax is an actual credit of income tax based on the estimated tax based on the net profit of the taxpayer. The Business licence credit is a deemed pre-payment of income tax. This is what the Notes to the 1977 amendment that introduced section 41 states.

27 Section 41 was a section inserted in the Act in 1977. According to the Notes accompanying the introduction of the section, the purpose of the section was to allow the Commissioner of Income Tax to treat (deem) business licence fees paid to local councils as a prepayment of income tax (credit) instead of as a business expense.

**Alternative view**

28 The alternative view is that a business licence should be offset against tax chargeable first because otherwise it disadvantages taxpayers who have paid provisional tax or withholding tax by minimizing the offset benefit they can receive from their or the? business license fee. This becomes a disincentive for people to pay provisional tax.

29 The alternative view is based on maximising the business licence offset and the fact that the Income Tax Act does not provide an order in which credits for tax are to be offset. The view is that the use of the term "tax chargeable" rather than "tax payable" would seem to imply that the offset should occur before any actual payments have been applied. Tax payable is the amount of tax charged left to be paid after any prepayments have been applied. However, section 83(6) provides that the Commissioner shall credit against the tax chargeable any installments paid for that year under subsection (5) and shall recover the balance or refund the excess as necessary. Accordingly, both the business licence credit and the

provisional tax credits are offset against tax chargeable.

30 Whilst the Commissioner's position disadvantages taxpayers by minimizing the offset benefit they can receive from their business licence fee; it is to be remembered that the fee is not a tax paid on income but a deemed pre-payment of tax. Section 41 creates a deemed credit for licence fees which would normally be a deduction from income. However, it is subject to the conditions that:

(a) it is to be offset against so much of the tax charged for profits received from carrying on that same business, not against tax payable and

(b) cannot create a refund in the event that the amount of the business licence fees exceeds "such tax charged on him"

**Other matters to note**

31 A business licence fee offset is allowed only:

(a) if the return is filed in or on time or further time allowed by the Commissioner and

(b) the business licence fee must first be added back as an expense before it can be used as an offset;

32 If the Business Licence fee is not allowed as an offset because there is no tax chargeable, the amount of the expense can be claimed as a business operating expense, or if only a proportion is off set; then the balance can be claimed as a deduction from net income. The effect of this means that there is a lower tax chargeable and payable; and

33 If the provisional tax payments are greater than the tax charged, then no amount of business licence fee can be offset.

34 Examples

**EXAMPLE 1**

Taxpayer A earns income not subject to provisional tax (such as investment income and salary and wages income).

Taxpayer A has paid a business license fee of $2,500. Taxpayer A files his income tax return on time and attaches a copy of the receipt for the business license fee payment.

Taxpayer A is assessed on an amount of $1,000 on the income returned.

After deducting a $1,000 credit from the business license fee amount (Taxpayer A had up to $2,500 credit available for this), no tax is payable.

Taxpayer A is not required to pay tax in this assessment and will not receive a refund of the unused $1,500 business license fee. Instead Taxpayer A can claim a deduction for the used $1,500 business license fee.

**EXAMPLE 2**

Taxpayer B earns business income subject to provisional tax. She pays $800 in

provisional tax during the year. Taxpayer B has paid a business license fee of $2,500.

Taxpayer B files her income tax return on time and attaches a copy of the receipt for the business license fee payment.

Taxpayer B is assessed on an amount of $1,000 on the income returned. After the $800 in provisional tax is credited to her, Taxpayer B has a balance owing of $200.

After deducting a $200 credit from the business license fee amount (Taxpayer B had up to $2,500 credit available for this), no tax is payable.

Taxpayer B is not required to pay tax in this assessment and will not receive a refund of the unused $2,300 from the payment of the business license fee. Instead Taxpayer B like Taxpayer A can claim a deduction for the used $1,500 business license fee.

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**PUBLIC RULINGS**
(Section 149)

**IT PUBLIC RULING 2024/7**
*(Previously 2016/1)*

## TAX TREATMENT OF INTEREST-FREE, LOW-INTEREST LOANS AND NON-RECOURSE LOANS PROVIDED TO EMPLOYEES UNDER SECTION 5 OF THE INCOME TAX ACT

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act Cap 123.

### TAXPAYER PROTECTION

2 This Ruling provides you with the following level of protection:

This Ruling sets out how a tax law applies in relation to a type of person or a type of arrangement.

You can rely on this Ruling (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement in this Ruling turns out to be incorrect because of a Court decision and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

### TAXATION LAWS

3 All legislative references to "the Act" are to the Income Tax Act CAP 123.

### PERSONS AND ARRANGEMENTS TO WHICH THIS RULING APPLIES

4 This Ruling sets out the Commissioner's interpretation of the application of section 5 of the Act to interest-free, low-interest and non-recourse loans provided by employers to their employees.

5 Employers are able to provide their employees with a range of benefits, which benefits are being offered because of the employment relationship. One type of benefit is an interest-free or low-interest loan. These loans will be offered at interest rates below the market interest rate, and in some cases, interest-free.

6 Another type of benefit is a nonrecourse loan. A non-recourse loan is a loan which the employer does not require the employee to repay, no matter what the interest rate is. It is often a payment of income disguised as a loan. In such cases the entire principal amount of the loan will be treated as income of the employee in the year the loan is made.

7 The commentary below explains the Commissioner's reasoning that interest-free, low-interest loans and non-recourse loans are benefits-in-kind under section 5(1)(b) of the Act and constitute employment income to the employee receiving the benefit.

## HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT

*Are interest-free, low-interest and non-recourse loans benefits-in-kind under section 5(1)(b)?*

8 Yes, the Commissioner considers that interest-free, low-interest loans and non-recourse loans are benefits-in kind under section 5(1)(b) of the Act. As such they are "employment income" of employees under the definition of that term in section 2 of the Act, and are chargeable to tax under section 3(1)(a)(ii) of the Act. Directors are also employees for the purposes of the Act by virtue of paragraph (a) of the definition of "employment".

9 The value of the benefit is determined by comparing the interest rate charged on the loan and the interest rate for "Personal loans weighted average" published monthly by the Central Bank of Solomon Islands as the market interest rate. The value of the benefit is the difference between the two rates.

10 As an alternative, employers may use the market interest rate for loans of a similar character. The value of the benefit is the difference between the two rates. For the purposes of determining the value of the benefit for an interest-free loan, the loan is treated as having an interest rate of 0%. Under section 36A of the Act, employers are required to include the value of the benefit in the relevant employee's gross employment income, from which they must deduct tax as prescribed in the Tax Deduction Rules 2005.

## DATE OF EFFECT

11 This Ruling applies to years of income commencing both before and after its date of issue. This Ruling was previously issued in 2016 for one year this

Ruling extends that Ruling indefinitely. However, this Ruling will cease to apply immediately if any of the provisions or rules relied upon in this ruling are amended or repealed.

Dated this twenty-eight day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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## COMMENTARY

1 This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Income Tax Act Cap 123 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

## SUMMARY

3 Where a person is engaged in employment, the person is an employee for the purposes of the Act. The definition of "employment" is extremely broad, and non-exhaustive. Therefore, "employment" as understood in common law and in ordinary concepts and usages also falls within the range of the definition to the extent it is not expressly covered.

4 The use of the phrase "engaged in employment" in the definition of "employee" restricts its meaning so that only taxpayers currently engaged in the relevant employment are "employees" for the purposes of the Act.

5 "Employment income" is defined as the gains and profits from employment as determined by section 5. Section 5 sets out the various things that are treated as employment income under the Act. Included as employment income is the value of any benefit-in-kind, whether convertible to money or not. Therefore, the value of a benefit-in-kind is employment income. A benefit-in-kind is a benefit provided to an employee by their employer by virtue of their employment relationship.

6 In an ordinary sense, there can be little doubt that an interest-free or low interest loan is a benefit to the employee. However, it is necessary to determine whether a low-interest loan is a benefit-in-kind for the purposes of the Act.

7 Historically, determining whether a benefit provided to an employee was assessable income turned on whether the benefit was convertible to money or money's worth. If a benefit is not convertible into money or money's worth, then it is not something that "comes in" and so cannot be regarded as income.

8 The convertibility principle was initially established in the English case of Tennant v Smith [1892] 3 T.C. 158. The House of Lord's decision in Tennant v Smith involved a bank employee who received a benefit in the form of

rent-free accommodation. The issue before their Lordships was whether the accommodation was assessable under Schedule E of the UK legislation (by virtue of the words "salaries, fees, wages, perquisites or profits payable"). The Court held that the taxpayer would only be taxable if what he received was convertible into money, i.e. was money or money's worth. Because the taxpayer could not sublet the accommodation or turn the accommodation to pecuniary account in any other way, he was not taxed. Summarising the reason for their Lordships decision, Lord Field provided:

> "For the reasons which have been so fully indicated to your Lordships, it appears to me that the residence of the Appellant upon the bank premises which, although rent free, could not in any way be converted by him into money or money's worth, cannot be held to be either a gain or profit, or perquisite or emolument within the meaning of the statutes."

9 The convertibility principle has been discussed and applied by the New Zealand Courts on a number of occasions. The leading example of this is the Supreme Court's decision in Dawson v C of IR (1978) 3 NZTC 61,252 (SC) where the Court found that Mr. Dawson's right to use a colour TV set in return for subscribing to a debenture issue, was not income because that benefit was neither money nor capable of conversion into money. In finding for the objector, Mr. Dawson, McMullin J concluded that:

> "In the present case, the benefits received by objector were not in monetary form nor were they capable of being sold, surrendered, assigned or mortgaged for money or money's worth. Indeed, sale, surrender, assignment and mortgaging were expressly forbidden by the agreement. The substantial benefit which objector received from the investment was that he did not have to pay rental for the set. That does not constitute income, not being money or capable of conversion into money."

10 The convertibility principle was also adopted in Australia, as highlighted in the decision of the Full Federal Court in *FC of T v Cooke & Sherden*.[1] In that case, the taxpayers carried on business as "home delivery" soft drink retailers. The manufacturers of the soft drinks operated a free holiday scheme as an incentive to the retailers. Where retailers meet their allotted sales quotas, the manufacturers paid the airfares and accommodation expenses for holidays in Queensland and certain South Pacific islands. The holidays were nontransferable and could not be cashed in. The Commissioner assessed the taxpayers on the value of the holidays. The Court found that the benefit of the holidays was not taxable in the hands of the taxpayers. In their judgement Brennan, Deane and Toohey JJ stated:

> "It is immaterial that the respondents would have had to expend money themselves had they wished to provide the holidays for themselves. If the receipt of an item saves a taxpayer from incurring expenditure, the saving is not income: income is what comes in, it is not what is saved from

*1 80 ATC 4140*

going out. A non-pecuniary receipt can be income if it can be converted into money; but if it be inconvertible, it does not become income merely because it saves expenditure.

The holidays which were enjoyed by the taxpayers in the present case provided them, at a cost to the manufacturers, with a non-convertible benefit."

11 Interest-free or low-interest loans are analogous with the holidays considered in *FC of T v Cooke & Sherden*. Like them, interest-free or low interest loans provide a saving to the borrower, being the difference between the interest charged and that which would have to be paid if the loan were taken out at arms-length.[2] In short, it is a non-convertible benefit to the employee. In the case of a non-recourse loan, the saving is that the loan does not have to be repaid. The full amount of the non-recourse is a benefit-in-kind and employment income.

12 In order to overcome these Court decisions, Parliament enacted section 5(1)(b), which overrides the convertibility principle by including benefits-inkind whether they are convertible to money or not. Thus, the interest saving from an interest-free or low-interest loan provided to an employee because of the employment relationship is a benefit in kind under section 5(1)(b), and is profits or gains from employment.

13 Next, it is necessary to determine whether the benefit-in-kind is "from employment". This amounts to determining whether, in any particular instance, the provision by an employer of an interest-free, low-interest or non- recourse loan to an employee has a connection with the employee's employment. The Federal Court of Australia held in J & G Knowles & Associates v FC of T[3] that, for a benefit to be "in respect of" employment there is required: "*some discernible and rational link, between the benefit and employment*"

14 The phrase "in respect of" is considered to be sufficiently similar to the word "from" used in section 5, that the principle cited above can be applied to determine whether a benefit is "from employment" under the Act. This can only be determined on a case-by-case basis.

15 In the usual case, the Commissioner considers that the provision of an interest-free, low-interest or non-recourse loan to employees will represent a benefit-in-kind from employment. However, the potential scenarios in which such loans could be provided are sufficiently varied that the Commissioner cannot attempt to define the situations where these may occur.

16 While not the focus of this Ruling, it is also worth noting that a benefit provided by an employer to a person associated with the employer, could potentially

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2 *The common meaning of arm's length value is the amount that the recipient could reasonably be expected to have been required to pay to obtain the benefit from the provider under a transaction where the parties to the transaction are dealing with each other at arm's length (that is, the parties have no significant relationship with each other) in relation to the transaction.*

3 *2000 ATC 4151*

be a benefit-in-kind under the Act. This is particularly so where the benefit is provided because of the employee's employment.

17 The value of the benefit is to be determined by comparing the interest rate charged on the loan, and the market interest rate for loans of a similar character. The value is the difference between the two rates. Note that when performing this exercise, an interest-free loan has an interest rate of 0%.

18 For ease of compliance, the Commissioner considers it is acceptable to use the 'Personal loans weighted average' interest rate, published monthly by the Central Bank of Solomon Islands, as the market interest rate when calculating the value of the benefit. This market interest rate must be compared with the interest rate at which the employer is providing the loan to the employee.

19 Alternatively, employers are able to determine what the market interest rate for loans of a similar character is. In order to do this, consideration must be given to the characteristics of the loan provided to employees, these include:

(a) Whether not the loan is secured against any assets, guarantees or other collateral;

(b) Whether the loan has a fixed or adjustable interest rate;

(c) The class of persons to whom the loans are provided;

(d) All risks associated with the loan.

20 Once these and any other relevant characteristics have been identified, the employer providing the loans must then determine the market interest rate for loans of a similar character, provided on an arms-length basis.

21 The value of the benefit, thus determined (using either method), is subject to tax. Section 36A of the Act obliges an employer to deduct tax from an employee's gross employment income, in accordance with the Tax Deduction Rules 2005.

22 As the value of the benefit from an interest-free, low-interest or nonrecourse loan is a benefit-in-kind under section 5, it is employment income.

Thus, the employer must add the value of the benefit to the salary or wages (and any other employment income) of the employee, and then deduct tax as prescribed in the Tax Deduction Rules 2005.

23 The value of the benefit is derived by the employee daily. Therefore, the employer should calculate the benefit to the employee at the end of each pay period. The actual value of the benefit can be obtained by comparing the actual interest incurred with the amount of interest that would have accrued using the market interest rate for that period.

**EXAMPLE**

Employee A receives a $10,000 loan for a term of 2 years from their employer with an interest rate of 5% per annum.

The current 'Personal loans weighted average' interest rate, published by the Central Bank of Solomon Islands is 12%. The benefit is 7% of $10,000 that is $700 for each of the 2 years of the loan.

The value of the benefit is derived by the employee daily. Therefore, the employer should calculate the benefit to the employee at the end of each pay period. The actual value of the benefit can be obtained by comparing the actual interest incurred with amount of interest that would have accrued using the market interest rate for that period

If the loan is forgiven, then the balance remaining is a taxable benefit and should be taxed at the time of forgiveness of the loan.

## APPENDIX 1

**Legislation**

**Non-cash benefits**

The application of the following sections of the Act are considered in this Ruling:

Section 2(1) "In this Act, unless the context otherwise requires:

"***employee***" means an individual engaged in employment;

"***employer***" means a person who engages or remunerates an employee;

"***employment***" includes:

(a) a directorship or other office in the management of a company or body of persons;

(b) a position entitling the holder to a fixed or ascertainable remuneration;

(c) the holding or acting in any public office;

(d) performance under a contract principally for work or services where the Minister provides by Order that the relationship will be regarded as one of employment for the purpose of the tax deduction provision; or

(e) performance under a contract principally for work or services where the parties voluntarily agree with the Commissioner that the relationship will be regarded as one of employment for the purpose of the tax deduction provision;

"***employment income*** " means gains or profits from employment as determined under section 5 of the Act;

Section 3(1) Subject to this Act, tax shall be charged for each year upon the income for that year of any person in respect of:

(a) gains or profits from:

(i) ……..

(ii) employment; or

(iii) any right granted to any other person for the use or possession of any property.

Section 5 (1) For the purposes of section 3(1)(a)(ii) and subject to subsection (2), gains or profits from employment means any amount, whether of a revenue or capital nature, arising from employment, including:

(a) any wages, salary, leave pay, payment in lieu of leave, overtime pay, bonus, commission, fees, gratuity, or work conditions supplements, and including any remuneration paid to the holder of an office;

(b) the value of any benefit-in-kind, whether convertible to money or not; Section 36 A (1) Subject to subsection (2), an employer shall deduct tax from the gross amount of employment income paid to an employee as prescribed in the Tax Deduction Rules 2005.

(2) This section does not apply to employment income that is exempt from income tax.

(3) The obligation of an employer to deduct tax under subsection (1)

(a) shall not be reduced or extinguished because the employer has a right, or is otherwise obliged, to deduct any other amount from a payment of employment income; and

(b) shall apply notwithstanding any law that provides that the employment income of an employee is not to be reduced or subject to attachment."

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**PUBLIC RULINGS**
(Section 149)

**PUBLIC RULING 2024/8**
*(Previously PR 2019/1)*

**INCOME TAX: MANAGEMENT SERVICES AND PROFESSIONAL SERVICES**

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act Cap 123.

**Taxpayer Protection**

2 This Ruling provides you with the following level of protection:

This ruling sets out how a tax law applies in relation to a type of person or a type of arrangement.

You can rely on this Ruling (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement in this Ruling turns out to be incorrect because of a court decision and you underpay your tax as a result, you will not have to pay a penalty, nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in

good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

**Taxation Laws**

3 All legislative references to "the Act" are to the Income Tax Act Cap 123.

**Persons and Arrangements to which this Ruling applies**

4 This Ruling applies to persons including companies that provide management services or professional services to persons. The Ruling provides guidance as to what are management services and what are professional services for the purposes of sections 37 and 38 of the Act.

5 The Minister of Finance and Treasury on 1st March 2018, pursuant to his power in subsection 37(2)(i) of the Act, issued an Order subjecting the income from professional services and 37(2)(j) management services of a resident person to the withholding tax provisions.

6 Accordingly, this Ruling applies equally to residents providing management and professional services with the proviso that those residents paying provisional tax and/or PAYE withholding are not subject to the resident withholding tax provisions.

7 This Ruling considers the various indicators, within the common law meaning of the terms, management services and professional services, to work out whether a person is providing management or professional services.

**HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT**

**Meaning of management services**

8 A payment for management services is a payment for services rendered:

(a) in whole or in part in the Solomon Islands; or

(b) outside the Solomon Islands for the provision of:

(c) industrial or commercial information

(d) advice on management

(e) administration, or

(f) control of the operations of any company or entity.

It excludes payments for employment income or reimbursement of related travel or accommodation expenses.

9 Payments for management services are often paid to a person, including a company, for managing a business, property, sum of money etc. on behalf of another person. Management services involve the actual oversight and control of the organization and its business processes.

10 Services such as payroll system advice or similar services provided by an overseas entity are usually considered management services, except if the parties are not related.

**Meaning of Professional services**

11 Professional services is defined also in section 38(2), as any payment made by a person to another person or entity:

(a) in whole or in part in the Solomon Islands; or

(b) outside the Solomon Islands for the provision of:

(c) Professional or technical services, or

(d) services of an adviser or consultant on behalf of a person or entity resident in the Solomon Islands.

It includes payment of a commission, whether on sales or otherwise.

It excludes payments for employment income or reimbursement of related travel or accommodation expenses.

12 Both definitions also apply to residents.

13 Professional services rely largely on the personal labour or intellectual input of the service provider. This also applies to contractors (who are not employees) providing professional or technical services.

**The difference between management services and professional services**

14 Management services are fees paid to a person, including a company, for managing a business, property, sum of money etc. on another's behalf.

15 Whereas professional services are fees charged by individuals specially trained in specific fields of arts and sciences, such as doctors, architects, lawyers and accountants. Professional services payments include commissions whether on sales or otherwise.

16 Professional services are more technical in nature and these services are usually applied on specific technical issues related to an organisation. On the other hand, management services involve the actual oversight and control of the organisation (business processes).

17 The elements to be considered when making the distinction between management and professional services includes such matters as:

(a) the nature of the service;

(b) the timing in which the service is carried out;

(c) the relationship that exists between the organisation and the service provider; and

(d) the terms of any contract.

**DATE OF EFFECT**

18 This Ruling applies to years of income commencing both before and after its date of issue. This 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 final Ruling.

Dated this eighteenth-day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**COMMENTARY**

1 This Commentary is not a legally binding statement. The Commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Income Tax Act Cap 123 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

**Summary**

3 This commentary provides guidance as to what are management services and what are professional services for the purposes of section 38 of the Act. That section defines management and professional services for the purposes of withholding tax provisions for non- residents. It also applies to payments made to residents.

4 The Minister of Finance and Treasury on 1st March 2018, pursuant to his power in subsection 37(2)(i) of the Act, issued an Order subjecting the income of management and professional services of a resident person to the withholding tax provisions. Accordingly, this Ruling applies equally to residents providing management and professional services with the proviso that those residents paying provisional tax and/or PAYE withholding are not subject to the resident withholding tax provisions.

5 This Ruling considers the various indicators, within the common law meaning of the terms, management services and professional services, to work out whether a person is providing management services and professional services. The distinction is important as different withholding tax rates apply to each of them (35% for management services and 20% for professional services). Persons making payments and persons receiving payments should follow the terms of this Ruling to determine the distinction between management services and professional services.

**Meaning of income from management services**

6 In the Act "Income from management services" is defined in subsection 38(2).

A payment for management services is a payment for services rendered:

(a) in whole or in part in the Solomon Islands; or

(b) outside the Solomon Islands

for the provision of:

(i) industrial or commercial information

(ii) advice on management

(iii) administration, or

(iv) control of the operations of any company or entity.

It excludes payments for employment income or reimbursement of related travel or accommodation expenses.

7 Payments for management services are often paid to a person, including a company, for managing a business, property, sum of money etc. on behalf of another person. Management services involve the actual oversight and control of the organization and its business processes.

8 Services such as payroll system advice or similar services provided by an overseas entity are usually considered management services, except if the parties are not related.

**Meaning of professional services**

9 Professional services is defined also in section 38(2).

A payment for professional services is a payment for services rendered:

(a) in whole or in part in the Solomon Islands; or

(b) outside the Solomon Islands

for the provision of:

(i) professional or technical services, or

(ii) services of an adviser or consultant

on behalf of a person or entity resident in the Solomon Islands.

It includes payment of a commission, whether on sales or otherwise.

It excludes payments for employment income or reimbursement of related travel or accommodation expenses.

10 Both definitions also apply to residents.

11 Professional services rely largely on the personal labour or intellectual input of the service provider. This also applies to contractors providing professional or technical services (who are not employees).

**The difference between management services and professional services**

12 When the legislation increasing the rate of non-resident withholding tax for professional and technical experts was introduced in July 2007, the intention was

that a professional services payment would mean any payment for professional or technical services of an advisor or services of an advisor or consultant on behalf of a person or entity resident in the Solomon Islands. This is on the basis that these services rely largely on the personal labour or intellectual input of the service provider. This also applies to contractors providing professional or technical services who are not employees or considered to be employees.

13 Professional services are fees charged by individuals specially trained in specific fields of arts and sciences, such as doctors, architects, lawyers and accountants. Professional services payments include commissions whether on sales or otherwise.

14 Whereas management services are fees paid to a person, including a company, for managing a business, property, sum of money etc. on another's behalf.

15 Professional services are more technical in nature and these services are usually applied on specific technical issues related to an organisation. On the other hand, management services involve the actual oversight and control of the organisation (business processes).

16 The elements to be considered when making the distinction between management services and professional services includes such matters as:

(a) the nature of the service provided;

(b) the timing in which the service is carried out;

(c) the relationship that exists between the organisation and the service provider; and

(d) the terms of any contract.

17 In cases of services such as payroll system advice and similar services provided by an overseas associated party, these would be considered management services. If the parties are not related, then it can usually be concluded that they are not management services.

## EXAMPLES

### Management services

18 Ace Payroll Company Limited is a non-resident company of the Solomon Islands. It provides advice on how to set up a payroll system to Ace (Solomon Islands) Limited a related company. The services Ace Payroll Company Limited provides would be considered to be management services.

19 Ace Payroll Company Limited also provides payroll processing services to Ace (Solomon Islands) Limited. This is considered to be management services as the companies are related. If the companies were not related they would be considered professional services.

**Professional services**

20 Anthony is an Australian lawyer who provides tax legal advice to Sol Company Limited. He is engaged on a retainer basis, that is, a fee paid in advance in order to secure Anthony's services as required. The services Anthony provides would be considered to be professional services.

21 Peter runs a real estate agency which provides various services. He manages properties for clients and provides advice on management and administration of the properties. Payments for these services would be considered to be Management services. Peter also sells properties on behalf of clients and receives commission payments. This would be professional services under the definition.

**APPENDIX 1**

**Legislation**

**Residents**

Subsection 37(1) of the Income Tax Act Cap 123 provides that a person who pays a resident income to a resident person shall deduct from such gross payment income tax at the appropriate withholding tax rate specified in the Seventh Schedule.

Under subsection 37(2) resident withholding tax consists of, amongst other income:

(a) professional services;

(b) income from management services; and

**Non-residents**

Subsection 38(1) of the Income Tax Act provides that a person who pays nonresident income to a non-resident person shall deduct from such gross payment income tax at the appropriate withholding tax rate specified in the Sixth Schedule and that such income is deemed to be derived from the Solomon Islands.

Subsection 38(3) of the Income Tax Act Cap. 123 provides that non-resident income subject to non-resident withholding tax includes:

(a) professional services;

(b) income from management services and

The rate of both resident and non-resident withholding tax for payments for professional Services is 20 cents (20%) in the dollar and for income from management Services it is 35 cents (35%) in the dollar as set out in the Sixth and Seventh Schedules.

**PUBLIC RULING**
(Section 149)

**PUBLIC RULING 2024/9**
*(Previously ST 02/2016 as amended by an Addendum in March 2019)*

# THE CHARGING OF SALES TAX ON THE SALE AND SERVICING OF COMPUTERS

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Sales Tax Act Cap 125.

## Taxpayer Protection

2 This Ruling provides you with the following level of protection:

This Ruling sets out how a tax law applies in relation to a type of person or a type of arrangement.

You can rely on this Ruling (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement in this Ruling turns out to be incorrect because of a court decision and you underpay your tax as a result, you will not have to pay a penalty. nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

## Taxation Laws

3 All legislative references to "the Act" are to the Sales Tax Act Cap 125.

## Persons and Arrangements to which this Ruling applies

4 This Ruling applies to persons providing computer services to persons. The Ruling provides guidance as to what are professional services for the purposes of item 11 of Schedule One of the Act. The Schedule defines professional services for the purposes of the Act and what goods and services are subject to Sales Tax.

## HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT

### Is the sale of a computer a professional service chargeable to sales tax?

5 The previous Public Ruling Sales Tax PR ST 02/2016 advised that the sale of a computer was a "professional service" under the Sales Tax law and so was liable to have Sales Tax charged of 10% to the purchaser of the sale value of the computer. An addendum, issued in March 2019, reversed this Ruling.

6 The Commissioner, in the addendum, reexamined his interpretation and considered that it is the services in respect of the sale of the computer that is liable to Sales Tax rather than the sale value of the computer. The sale of the Computer

would generally have Goods Tax imposed on it. Whereas services connected to the sale such as services in respect of package, manuals, maintenance and training are subject to Sales Tax.

7 The addendum thus clarified that it is the services in respect of the sale of the computer that is liable to Sales Tax rather than the sale value of the computer.

**Meaning of "*Professional services*" in respect of computer services**

8 The Professional services connected to the sale such as services in respect of package, manuals, maintenance and training are subject to Sales Tax.

9 Professional services relating to sale of computers would represent amounts charged for the time spent by a consultant, technician or an advisor for:

(a) giving advice to a customer in relation to what computers or packages would be appropriate for their organisation, for example, advice on system requirements or suggested ICT solutions for a particular business environment;

(b) preparation of a manual detailing how a computer system operates;

(c) the value of services to add commonly used office software such as word processing, spreadsheets, antivirus and games to the computer;

(d) time spent on maintaining the computer, for example by performing virus scans or cleaning up the directory for the customer;

(e) time spent providing training on how to use the computers; or

(f) repair of a computer or its parts.

**DATE OF EFFECT**

10 This Ruling applies to Sales Tax periods commencing both before and after its date of issue. This 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 final Ruling.

Dated this eighteenth-day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**COMMENTARY**

1 This Commentary is not a legally binding statement. The Commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Sales Tax Act Cap 125 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

**Summary**

**Is the sale of a computer a professional service chargeable to sales tax?**

3 The previous Public Ruling Sales Tax PR ST 02/2016 advised that the sale of a computer was a "professional service" under the Sales Tax law and so was liable to have Sales Tax charged of 10% to the purchaser of the sale value of the computer. An addendum, issued in March 2019, reversed this Ruling.

4 The Commissioner, in the addendum, reexamined his interpretation and considered that it is the services in respect of the sale of the computer that is liable to Sales Tax rather than the sale value of the computer. The sale of the computer would generally have Goods Tax imposed on it. Whereas services connected to the sale such as services in respect of package, manuals, maintenance and training would have Sales Tax imposed on them.

5 The Commissioner acknowledged in the addendum that the wording of the definition in Schedule One of the Act of computer services "(including sale of computer, package, manuals, maintenance and training)" implies that Sales Tax is charged on sales of computers. However, the Commissioner is of the opinion that the words "services in respect of" should be read into

(ii) of the definition of computer services after the word "including".

6 To read otherwise would be to imposing Sales Tax on an item which has already had Goods Tax imposed on it and for which no professional services have been provided. In other words, it would lead to an absurd result of having both Goods Tax and Sales Tax imposed on the one event. The Commissioner is of the view that Parliament could only have intended to make services in respect of the sale of the computer liable to Sales Tax rather than the sale of the computer itself.

7 The addendum thus clarified that it is the services in respect of the sale of the computer that is liable to Sales Tax rather than the sale value of the computer.

**Meaning of "*Professional services*" in respect of computer services**

8 The Professional services connected to the sale such as services in respect of package, manuals, maintenance and training are subject to Sales Tax.

9 Professional services relating to sale of computers would represent amounts charged for the time spent by a consultant, technician or an advisor for:

(a) giving advice to a customer in relation to what computers or packages would be appropriate for their organisation, for example, advice on system requirements or suggested ICT solutions for a particular business environment;

(b) preparation of a manual detailing how a computer system operates;

(c) the value of services to add commonly used office software such as word processing, spreadsheets, antivirus and games to the computer;

(d) time spent on maintaining the computer, for example by performing virus scans or cleaning up the directory for the customer;

(e) time spent providing training on how to use the computers; or

(f) repair of a computer or its parts.

**EXAMPLES**

**EXAMPLE 1**

Solcomputer Limited imports computers for sale. The computers cost $2,000 to import. It pays Goods Tax on the cost at the wharf in addition to the Import Duty. It also imports computer games and pays Import Duty and Goods Tax.

At its store it unpacks the computers and installs some software into the computer. It then places the computer on display. Eric buys the computer from Solcomputer with the installed software for $2,500 and requests that Solcomputer install some computer games which he had purchased onto the computer.

Solcomputer is liable to charge Eric Sales Tax on the value of the services for installing the software to the computer and installing the computer games. It is not liable charge Sales Tax on the value of the computer nor the value of the software and computer games. For example, it takes 1 hour to install the software and games. Solcomputer charges $100 for this service. Solcomputer should charge Eric $10 sales tax for the service.

**EXAMPLE 2**

Eric comes back to Solcomputer one week later and asks for one of its staff to train him on how to use the computer. This takes two hours and Solcomputer charges Eric $150 for the training. Solcomputer should charge Eric $15 sales tax for the service.

**APPENDIX**

**LEGISLATION**

Item 11 of Schedule one of the Sales Tax Act Cap 125

"***professional services***" means all charges, fees and dues generally and reasonably arising from the sale of any professional, technical, advisory or consultancy services rendered and include;

(a) secretarial services;

(b) computer services (including sale of computer, package, manuals, maintenance and training);

(c) architectural services (including services in respect of drafting of plans, sketches or drawings);

(d) sign writing, design, mural painting, drawing and other related services;

(e) surveying and valuation fees;

(f) civil, electrical or mechanical engineering services (including panel beating and body repair work);

(g) management and trustee services;

(h) marine engineering services;

(i) building/construction engineering.

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**PUBLIC RULING**
(Section 149)

**PUBLIC RULING 2024/10**

**INCOME TAX: WRITING OFF OF DEBTS AS BAD**

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act Cap 123.

**TAXATION LAWS**

2 All legislative references to "the Act" are to the Income Tax Act CAP 123. The Ruling applies to subsection 18(2)(a) of the Act.

**ARRANGEMENT TO WHICH THIS RULING APPLIES**

3 The Arrangement is the writing-off of a debt (or part of a debt) as a bad debt, for income tax purposes, in the following circumstances where:

(a) an existing debt is owing to the taxpayer; and

(b) the debt is incurred in the production of income; and

(c) the debt has been considered as "bad" by a reasonably practical commercial person who has concluded that there is no reasonable likelihood that the debt will be paid in whole or in part by the debtor or by anyone else (either on behalf of the debtor or otherwise); and

(d) the bad debt has been "written off" (in the income year for which a deduction is claimed), in accordance with the accounting and record keeping systems maintained by the taxpayer in one of the following ways:

(i) in the case of a large corporate or business taxpayer who maintains a computerised bad debts system, by an authorised person making the appropriate entry in that system recording the debt as written off; or

(ii) in the case of a company (other than one falling within the above class), by an executive or other responsible officer of the company with the authority to do so, making the appropriate bookkeeping entries in the books of account of the company recording the debt as written off; or

(iii) in the case of a taxpayer (other than a company) that maintains double-entry accounts, by an authorised person making the appropriate bookkeeping entries in the books of account of the business recording the debt as written off; or

(iv) in the case of a taxpayer who is an unincorporated sole trader or small unincorporated business taxpayer who does not maintain double-entry accounts, by the taxpayer noting, in the bookkeeping records of the taxpayer setting out the amount owed by the bad debtor, that the debt has been written off, and the date of the writing off.

**HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT**

4 The taxation laws that apply to the Arrangement are as follows:

Section 18(2)(a) of the Act

5 The requirements of 18(2)(a) of the Act will be satisfied and a person will be allowed a deduction for the amount of the bad debt that has been written off, provided the debt is:

(a) Bad;

(b) incurred in production of income – that is the amount of the debt was previously included in the gross income of the person;

(c) proved to satisfaction of the Commissioner to have become bad during the year – that is, there are reasonable grounds for believing that the debt is irrecoverable;

(d) and written off by the person- that is, the debt or part of the debt is written off in the accounts of the person in the fiscal year.

**DATE OF EFFECT**

6 This Ruling applies to years of income commencing both before and after its date of issue. This 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.

Dated this eighteenth-day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**COMMENTARY**

1 This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Income Tax Act Cap 123 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this

commentary.

**Summary**

3 Section 18(2)(a) of the Act allows for a deduction for bad debts if certain criteria are met. The key requirements are that the debt must be both bad and written off. This Ruling only considers the questions of when a debt becomes "bad" and when the bad debt will have been "written off".

4 This commentary will discuss firstly the requirements to be applied in deciding whether or not a debt is "bad", and secondly what actions are sufficient to "write off" a bad debt.

**First requirement - Debt must be "bad"**

5 The relevant time of inquiry as to whether a debt is bad is the time that the decision is made to write off the debt. A debt must be "bad" before it can be written off and before any deduction can be claimed for that debt. Whether or not a debt (or part of a debt) is bad is a question of fact to be determined objectively. A debt becomes a bad debt when a reasonably practical commercial person would conclude that there is no reasonable likelihood that the debt will be paid. The onus of proof is on the taxpayer. The standard to which the test must be proved is on the balance of probabilities, that is, more than 50%.

6 At the time of deciding whether a debt is bad, a person will therefore need to have sufficient information for a reasonably practical commercial person to form the view that there is no reasonable likelihood that the debt will be paid. This requires a bona fide assessment based on sound commercial considerations, that the debt is bad. Sound commercial judgment cannot be exercised, in relation to determining that a debt is bad, if there is still a real and continuing dispute as to whether or not the debt is payable. In such a situation, a taxpayer cannot at that point in time, on any objective view, come to the conclusion that the debt was bad. The debt must be more than doubtful.

7 Determining the question of fact as to whether a debt is bad depends on the circumstances surrounding any particular case. While no factor is decisive in itself, factors that are likely to be relevant in considering whether a debt is bad include:

(a) **the length of time a debt is outstanding** - the longer a debt is outstanding the more likely it is that a reasonably practical commercial person would consider the debt to be bad. This will of necessity vary depending upon the amount of the debt outstanding and the taxpayer's credit arrangements (e.g. 90, 120 or 150 days overdue). However, a debt will not be considered bad merely because a set period of time for payment has passed with no payment or contact having been made by the debtor. Similarly, a debt may have only been outstanding for a short period and still be regarded as bad where other evidence exists that the debt will not be collected;

(b) **the efforts that a creditor has taken to collect a debt** - the greater the extent to which a person has tried (unsuccessfully) to collect a debt, the more likely it is that a reasonably practical commercial person would consider the debt to be bad;

(c) **other information obtained by a creditor** - a creditor may have obtained particular information about a debtor, e.g. through business or personal networks, that would be a factor in leading a reasonably practical commercial person to conclude that a debt is bad. For example, a creditor may know that the debtor is in financial difficulties and has defaulted on debts owed to other creditors;

(d) **a debt may be considered bad if the debtor has died leaving no, or insufficient, asset**s out of which the debt may be satisfied;

(e) **the debtor cannot be traced** and the creditor had been unable to ascertain the existence of, or whereabouts of, any assets against which action could be taken;

(f) where the **debt has become statute barred** and the debtor is relying on this defence (or it is reasonable to assume that the debtor will do so), for non-payment;

(g) **if the debtor is a company, it is in liquidation or receivership** and there are insufficient funds to pay the whole debt, or the part claimed as a bad debt.[4]

(h) A **company debtor does not need to be insolvent** for a debt to be bad (although this will often be the case).

**Taxpayer's opinion**

8 In many instances, a taxpayer's considered opinion will suffice. However, the Commissioner also recognises that taxpayers have a financial interest in treating a debt as bad. Writing off a debt as bad entitles a taxpayer to a deduction in calculating income for income tax purposes.

9 Because of this, the Commissioner may inquire into the decision to treat a debt as bad in the course of tax audits or other enquiries. It is desirable, therefore, that taxpayers document and retain evidence in relation to their decisions to treat debts as bad to show that they made reasonable decisions. Documentation may include noting down the information from which the decision was made that the debt was bad, and keeping copies of any correspondence relating to the debt. It should be remembered that the onus of proof is on the taxpayer and the standard of proof is on the balance of probabilities, that is, the probability that the debt is bad is more than 50%.

**Information required**

4 *Bullet points 1-3 are from the New Zealand Inland Tax Ruling BR Pub 05/01 and dot points 4 - 7 are from Australian Taxation Office Public Tax Ruling 92/18 paragraph 31.*

10 The amount of information required to decide whether a debt is bad depends on the particular circumstances of each case. If the amount involved is small, a reasonably practical commercial person is likely to make limited enquiries and take limited recovery action. Particular knowledge or information obtained by a taxpayer may also reduce the need for enquiry. In the final analysis, however, the test is always whether the taxpayer has sufficient information to reasonably draw the conclusion that there is no reasonable likelihood that the debt will be paid, even if further or any recovery actions were to be taken.

**Recovery steps taken**

11 A creditor is likely to have taken legal steps to try to recover the debt in most cases before a deduction for a bad debt is made, although this is not a requirement that such action be taken before a decision is made that a debt is bad. However, it is through taking recovery action that most creditors will form an opinion as to whether a debt is bad. While recovery action is being taken, a debt can only be considered bad to the extent that a reasonably practical commercial person would consider there is no reasonable likelihood that the debt will be paid.

12 To establish that there is no reasonable likelihood that the debt will be paid, a reasonably practical commercial person would, in most situations, take steps to recover the debt instead of simply writing it off. This may encompass a range of actions including legal proceedings. The appropriate steps undertaken will vary according to the size of the debt and the resources available to the creditor to pursue the debt. A creditor might not take any steps in attempting to recover the debt where the information suggests that there is no hope of payment. The steps taken to recover the debt would generally be expected to include one or more of the following, depending upon the circumstances[5]:

(a) reminder notices issued and telephone/mail or e-mail contact is attempted;

(b) a reasonable period of time has been allowed to pass since the original due date for payment of the debt. This will vary depending upon the amount of the debt outstanding and the taxpayer's credit arrangements;

(c) formal demand notice is served;

(d) commencement of legal proceedings for debt recovery;

(e) judgment entered against the delinquent debtor;

(f) execution proceedings to enforce judgment;

(g) the calculation and charging of interest is ceased and the account is closed (a tracing file may be kept open; also, in the case of a partial write-off, the account may remain open);

(h) valuation of any security held against the debt;

5 *See Australian Taxation Office Goods and Services Tax Public Ruling GSTR 2000/2 paragraphs 41 and 42 and Australian Taxation Office Tax Public Ruling TR 92/18 paragraph 32.*

(i) sale of any seized or repossessed assets;

13 While the above steps are indicative of the circumstances in which a debt may be considered bad, ultimately the question is one of fact and will depend on all the facts and circumstances surrounding the transactions.

14 In some instances, taking recovery action may carry with it the reasonable expectation of recovery of some part of the amount involved. However, this will not always be the case. The decision to take recovery action and the extent of that action will depend on the circumstances surrounding any particular case. In some cases, the creditor may take no or only limited recovery action because enough information is held to form a reasonable view that the debt is bad. The amount of information needed depends on the circumstances.

15 On the other hand, the creditor may take recovery action even when a reasonable view has been formed that the debt is bad. For a number of reasons, the creditor might take recovery action even when it is believed that there is no reasonable likelihood that the debt will be recovered. This may be the case, for example, when the creditor has a policy of pursuing debtors to a certain extent to discourage customers defaulting on debt.

**Provision for doubtful debts**

16 Persons in business who provide credit often find it practical to make some provision for the likelihood that some of their debtors will not pay. This provision is generally calculated by estimating a percentage on the basis of past history, and applying that percentage to the total amount of debts owed to the business at balance date.

17 Bad debts are individually identifiable debts that are unlikely to be recovered (in practical terms). The provision for doubtful debts is an estimate of the amount that will become bad debts in the future. The Income Tax Act does not allow any deduction for provisions for doubtful debts, only for bad debts.

**Debts that are partially bad**

18 In some cases, there may be no reasonable expectation that the debt will be fully recovered, but there may be a reasonable expectation of partial recovery. In this case the part that the creditor has no reasonable expectation of recovering is a bad debt. It is only that part of the debt that the creditor is entitled to write off as bad and claim as a deduction for income tax purposes.

**Examples of when a debt is bad**

19 The following examples are included to assist in explaining the application of the law.

**EXAMPLE 1**

20 Supplier A has supplied goods on credit to Mr. M, a non-resident. Mr. M owes the supplier $2,000 for the goods. The supplier knows that Mr. M has left the

country, and that mail addressed to him is returned marked "Gone No Address" In this case, it is reasonable to assume that the debt will not be recovered. The money owed by Mr. M is a bad debt.

**EXAMPLE 2**

21 B owes $100,000 to a company. The credit controller for the company has considered the likelihood of default on every loan currently owing to the company. The credit controller has estimated the likelihood of default for B to be 5%, and wants to know if the company can consider $5,000 of that loan (5% of the $100,000 owing) to be a bad debt. Making an estimate of the likelihood of default on debts is not sufficient for a debt (or a percentage thereof) to be bad. It is not reasonable to assume that the debt is bad.

**EXAMPLE 3**

22 A local market stall has supplied $640 worth of bread and cigarettes to Mrs. C on credit. Mrs. C used to call at the stall every other day, but has not called at the stall for eight weeks and the stall owner has heard that someone else is living in the hut Mrs. C used to live in. The $640 is still owing. Given the relatively small amount owing and the information known to the stall owner, it is reasonable for the stall owner to make no further enquiries. On the basis of the stall owner's information, it can be assumed that the money is unlikely to be recovered. It is a bad debt. However, if the sum involved was somewhat larger, it may be reasonable to expect that the stall owner makes some further enquiries.

**EXAMPLE 4**

23 A solicitor has done work for Mr. D and billed him for $17,000. The solicitor is on the Board of Trustees of the school attended by Mr. D's children. The solicitor has sent out a number of reminder bills because the bill is 4 months overdue, but has had no response. Several of the solicitor's friends and associates have mentioned that Mr. D is in financial difficulty and has had one of his vehicles repossessed. The solicitor's office clerk has noted that Mr. D's name has been cited in the Gazette several times over recent months in respect of court action for unpaid debts. It is reasonable for the solicitor to characterise Mr. D's debt as a bad debt.

**Example 5**

24 A debtor of Mrs. E is a company in liquidation. Mrs. E has given the liquidator notice of a debt of $100,000 owed for goods and services supplied. Mrs. E is an unsecured creditor. The liquidator has held a meeting of creditors. Mrs. E attended the meeting and received formal notice of the outcome of the meeting. The liquidator has stated that unsecured creditors will probably receive something between 45 and 50 cents in the dollar. It is reasonable for Mrs. E to assume that $50,000 of the total debt is bad. Mrs. E is entitled to write off that part of the debt that is bad in the income year in which she received the formal

notice, and to claim a deduction for income tax.

**Example 6**

25 The same facts exist as in Example 5, but at a later date Mrs. E receives a letter from the liquidator who advises that the estimate of the likely recovery has been revised. It is now expected that unsecured creditors will be paid between 70 and 75 cents in the dollar. This does not affect the answer given above in Example 5. If, at any stage, Mrs. E receives payment of any part of the 50 cents in the dollar written off, Mrs. E must include it as gross income in the income tax return for the year in which it is received (this will give rise to an income tax liability unless there are losses to offset against it).

**Second requirement - Debt must be "written off"**

26 The Act allows taxpayers an income tax deduction for written off bad debts. It is not enough that a debt is bad: the bad debt must also be actually written off. Writing off the bad debt is important because this will fix the time at which the deduction can be made. Note that there is no requirement that a debt be written off in the year it becomes bad.

27 Taxpayers must therefore be able to show clearly that the debt has been actually written off as bad rather than just making a decision to do so. To meet the legislative requirement, there must be something written down in the books of account of the business stating that the debt is written off. Case law indicates that the minimum writing requirements to satisfy the "actually written off as bad" test will vary for different classes of taxpayer based on the differing nature and level of sophistication of the taxpayer's accounting records. However, no matter what form a taxpayer's books of account or accounting records may take, those existing in respect of a debt owed by a bad debtor must record that the taxpayer, or an authorised person on behalf of the taxpayer, having decided the debt is bad, has written off the debt accordingly. It is the writing off of the bad debt which converts it into a deductible debt.

28 What will be sufficient indicators to meet the written off test for various classes of taxpayer are set out below. The bad debt is "written off" in accordance with the accounting and record keeping systems maintained by the taxpayer in one of the following ways:

(a) in the case of a large corporate or business taxpayer who maintains a computerised bad debts system, by an authorised person making the appropriate entry in that system recording the debt as written off; or

(b) in the case of a company (other than one falling within the above class), by an executive or other responsible officer of the company with the authority to do so, making the appropriate bookkeeping entries in the books of account of the company recording the debt as written off; or

(c) in the case of a taxpayer (other than a company) that maintains double-

entry accounts, by an authorised person making the appropriate bookkeeping entries in the books of account of the business recording the debt as written off; or

(d) in the case of a taxpayer who is an unincorporated sole trader or small unincorporated business taxpayer who does not maintain double-entry accounts, by the taxpayer noting, in the bookkeeping records of the taxpayer setting out the amount owed by the bad debtor, that the debt has been written off, and the date of the writing off.

29 There may be some very exceptional cases, where less than the above writing off requirement is acceptable, such as where a taxpayer is unable to access the accounting records and a letter is sent to the Commissioner stating that the debt had been written off. Nevertheless, there remains a written requirement in all cases.

30 It is the writing-off that determines the time when a deduction for a bad debt can be claimed. The necessary writing-off must therefore take place before the end of the income year in relation to which the bad debt deduction is claimed. Writing-off a bad debt cannot be backdated. Therefore, if there are numerous debts to review, it is important to allow sufficient time for this exercise, as well as for completing all necessary "writing-off" accounting entries before the end of an income year, to enable any bad debts to be deducted in that year.

**Accounts kept by taxpayers**

31 Most taxpayers in business keep double-entry accounts. Double-entry bookkeeping is a method of recording transactions where for every business transaction, an entry is recorded in at least two accounts as a debit or credit. In a double-entry system, the amounts recorded as debits must be equal to the amounts recorded as credits.

32 If a person keeps double-entry accounting records, the bad debt must be struck out of the records on which the double-entry accounts are based. If debtors' ledgers are maintained, the writing-off will be able to be clearly shown by the appropriate bookkeeping entries having been made in the debtors' ledger by authorised persons. Generally, this means that the balance in the debtors' ledger for the individual debtor must be reduced by the amount of the bad debt. No matter what processes are followed in the course of preparing a person's double-entry accounts, it is the completion of the appropriate authorised entry/entries actually writing-off a debt (which it has been decided is bad in accordance with the tests already outlined) that is essential to deductibility.

33 In cases where a taxpayer does not keep double-entry accounting records and/or does not keep a debtor's ledger, the person must write the debt off according to the form of records used. This means that whatever the form of records used, those records showing the amount owed by the bad debtor must clearly show that the creditor, having made the decision that the debt is bad (in accordance with the

tests already outlined), has written the debt off accordingly.

34 Particular examples of bad debts that will be accepted by the Commissioner as having been written off are:

(a) if a taxpayer's only records of debts are copies of invoices issued, placing the invoice in a "bad debts" file and indicating on the invoice whether all or part of the invoiced amount is bad and the date, is sufficient.

(b) if a taxpayer's only records of debts are copies of invoices and copies of statements of account issued from a duplicate account book, marking the copy of the final statement sent out "bad debt – written off" (noting the amount of the debt that is bad and the date) is sufficient. Alternatively, it would also be sufficient for the taxpayer to place the relevant invoice in a "bad debts" file indicating on the invoice whether all or part of the invoiced amount is bad and the date this was done.

**Examples of when a bad debt is or is not written off**

35 The following examples are included to assist in explaining the application of the law.

General facts - The following facts apply to all the following examples:

(a) the taxpayer's income tax balance date is 31 December.

(b) the only question is whether a debt has been written off. All other criteria are satisfied.

(c) the debt is for goods and services supplied for money.

(d) the supply has been included in the taxpayer's gross income for income tax purposes.

**EXAMPLE 1**

36 The taxpayer maintains a debtors' ledger. The debtors' ledger is updated on 31 December 2022. The entries made include the journal entry writing off the bad debt. The bad debt is deductible in the year ending 31 December 2022.

**EXAMPLE 2**

37 The taxpayer maintains a debtors' ledger. The debtors' ledger is written up on 1 December 2023. The entries written up include the journal entry writing off the bad debt. The bad debt is deductible in the year ending 31 December 2023.

**EXAMPLE 3**

38 The taxpayer does not maintain a debtors' ledger. The taxpayer's only records of debts owing to him are copies of issued invoices. The taxpayer maintains only basic books of account, and his unpaid debtors are represented by loose-leaf filing of accounts and/or invoices issued in a ring-binder file. When a debt is

paid it (the account and/or invoice) is transferred to a separate file. The taxpayer ceases sending accounts for the debt in question in November 2023, putting a line across the copy of the last statement sent out in respect of the debt and marking it "Final" and leaves it in the unpaid debtors' file. The taxpayer is not entitled to a deduction for the bad debt in the year ended 31 December 2023. Simply marking the last statement issued as "Final" and leaving it in the unpaid debtors' file does not amount to writing off of the debt.

**EXAMPLE 4**

39 The taxpayer does not maintain a debtors' ledger. His only records of debts owing are copies of invoices and statements issued. In November 2023 the taxpayer became aware that a debt was bad. He stopped sending out statements for the debt and took no other action on it. In particular, he sent out no statements on the account in November and December 2023. The taxpayer continued to send out statements on all the other debts owing, including overdue accounts. The taxpayer keeps carbon copies of the statements of account in the duplicate account book from which the statements for issue are prepared. The taxpayer has tagged the final statement sent out in respect of the debt, circling the amount payable and marking it "bad debt - written off – November 2023". The taxpayer is allowed a deduction for the bad debt in the year ending 31 December 2023. The cessation of statements of account, recorded by their absence in the duplicate account book, and the tagging and marking of the final statement, amount to writing off the debt in his accounting system.

**EXAMPLE 5**

40 The taxpayer maintains a debtors' ledger. She wrote up the debtors' ledger on 31 December 2023. The entries written up include a journal entry writing off a bad debt. Her accountant prepares her accounts in March 2024. In the course of preparing the accounts, the accountant makes a general ledger entry recognising the bad debt as a result of the debtor's ledger entry made by the taxpayer on 31 December 2023. The bad debt is deductible in the year ending 31 December 2023, because the underlying accounting record of the debt was altered to recognise the bad debt on 31 December 2023.

**EXAMPLE 6**

41 The taxpayer does not maintain a debtors' ledger. Her only records of debts owing are copies of invoices issued. On 15 December 2023 she placed the invoice for the debt in question in a file marked "BAD DEBTS" noting on the invoice next to the total amount "debt bad – filed 15/12/23". The amount of trade creditors in the taxpayer's balance sheet as at 31 December 2023 includes the bad debt. The taxpayer's profit and loss statement for the year ending 31 December 2023 includes as income the sale that has become a bad debt. The profit and loss statement does not recognise any expense for bad or doubtful debts. The taxpayer's income

tax return for the year ending 31 December 2023 includes the profit and loss statement and a "tax reconciliation statement" showing the difference between the accounting income and the amount she believes to be income for income tax purposes. The tax reconciliation statement includes a deduction for the bad debt. The taxpayer is not allowed a deduction for the bad debt. Although the debt has arguably been written off in the underlying accounting records, she has not ceased to recognise the debt as an asset for accounting purposes.

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## APPENDIX 1

**Legislation**

**Extract from Income Tax Act Cap 123**

**PART V ASCERTAINMENT OF TOTAL INCOME**

**Section 18:**

(1) In ascertaining for any year the income of any person which is chargeable to tax in respect of any of the subjects of section 3 there shall be deducted all expenditure incurred in such year which is expenditure wholly and exclusively incurred by him in the production of such income and which is not expenditure in respect of which no deduction shall be allowed under section 20; and where under section 26 any income of an accounting period ending on some day other than the last day of such year is, for the purpose of ascertaining total income for any year, deemed to be income for any year, then such expenditure incurred during such period shall be treated as having been incurred during such year.

(2) Without prejudice to the operation of subsection (1), in computing the gains or profits of any person for any year chargeable to tax under section 3 (a), the following amounts shall be deducted:

(a) bad debts incurred in the production of the income which are proved to the satisfaction of the Commissioner to have become bad during the year and to have been written off by such person;

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## PUBLIC RULING
(Section 149)

## PUBLIC RULING 2024/11

## INCOME TAX: WHEN YOU CAN CLAIM A DEDUCTION FOR WEAR AND TEAR AND WHAT BALANCING CHARGE ON LAND AND BUILDINGS IS INCLUDED AS INCOME AND WHAT BALANCING DEDUCTION IS ALLOWED AS A DEDUCTION

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act

Cap 123.

**TAXPAYER PROTECTION**

2 This Ruling provides you with the following level of protection: This Ruling sets out how a tax law applies in relation to a type of person or a type of arrangement. You can rely on this Ruling (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement in this Ruling turns out to be incorrect because of a Court decision and you underpay your tax as a result, you will not have to pay a penalty nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

**TAXATION LAWS**

3 All legislative references to "the Act" are to the Income Tax Act (Cap. 123). This Ruling applies section 4(1)(e), 18(2)(c),18(2)(6), 20(1) and Schedule 4 of the Act.

**ARRANGEMENT TO WHICH THIS RULING APPLIES**

4 This Ruling specifically considers:

(a) whether land can be subject to a deduction for wear and tear, also known as depreciation;

(b) whether lease payments for the use of land is an allowable deduction;

(c) What wear and tear deduction can be claimed (if any) where:

(i) vacant land is purchased with a known cost;

(ii) a lease premium is paid for a fixed term estate grant;

(iii) vacant land is purchased and a building is subsequently constructed on the vacant land;

(iv) land and building are bought as a single property asset.

(d) What balancing charge is to be included in income under section 4(1)(e) of the Act;

(e) What balancing deduction is to be allowed as a deduction from income under paragraph 5 (1) of the Fourth Schedule;

(f) What values can be used in calculating wear and tear and balancing adjustments.

5 This Ruling does not consider whether wear and tear deductions are allowable for financing and operating leases. A Guide will be issued on issues relating to finance and operating leases and available on the IRD website.

## HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT

**Whether land can be subject to a deduction for wear and tear, also known as depreciation.**

6 Land is not specified in the Act or Schedule as a wear and tear deduction. This is because, prima facie, land is not an asset that diminishes in value.

7 An exception to this prima facie rule would be an improvement to land, or a fixture on land such as a building, where it would be recognised as an asset separate from the land.

**Whether lease payments for the use of land is an allowable deduction.**

8 The Commissioner considers that if land is subject to a lease arrangement, such that an annual lease amount is paid, then this is a deductible expense under the general deduction provision (subsection 18(1) of the Act) where the land is used to derive assessable income. Otherwise, a deduction is not allowable for an annual lease payment or a premium paid for the grant of a fixed term estate of land because of the operation of subsection 20(1) of the Act.

**Balancing deduction and balancing charge where:**

**(a) Vacant land is purchased with a known cost;**

9 As the cost of land, either by way of lease or premium, is not deductible if not used to derive assessable income, no balancing charge or balancing deduction is required to be made where vacant land is purchased. If the cost of land has been claimed incorrectly, then an amendment will be required to any returns in which land has been claimed as a deduction to reverse the deduction. For the period for which amendments are required, see the Date of Effect paragraph below.

**(b) A lease premium is paid for a lease of premises or a fixed term estate grant;**

10 The Commissioner accepts that this is a deductible expense where it is in relation to a lease of premises or fixed term estate used for the purposes of the production of income and should be made on a straight line basis for the term of the lease. A balancing charge may need to be calculated.

11 If the lease runs its full term, then no balancing charge is necessary as there is no "sale" and the written down value is nil. Also, if it is subleased before the end of the term of the lease, no balancing charge is required to be calculated. This is because rent would be received and there are no sale proceeds.

12 If there was a transfer of a lease of a fixed term estate, the amount received for the transfer of the lease of the fixed term estate minus (the lease premium amount less deductions claimed (if any)) would be a gain amount. The gain would be a non-taxable capital gain and not a balancing charge.

**(c) Vacant land is purchased, and a building is subsequently constructed on the vacant land;**

13 Where vacant land is purchased and then a building is subsequently constructed on it, only the original cost of the building can be claimed as a wear and tear deduction at the rate of 5% diminishing value.

14 No revaluation of the building is allowed at any time. Additions to the building, including improvements, can be claimed as a wear and tear deduction. Repairs and maintenance would be claimed as outright deductions in the year of repair or maintenance.

**(d) Land and building bought as a single property asset**

15 Where land is purchased which includes an existing building, the total cost cannot be claimed as a deduction for wear and tear.

16 If no allocation of land and building has been made at time of sale, then an apportionment must be made for the cost/value of the land at the time of purchase and the remaining value is the building cost/value which is claimable as a deduction.

**DATE OF EFFECT**

17 This Ruling applies to years of income commencing both before and after its date of issue. This 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.

18 Given the difficulty facing taxpayers in identifying situations over past years where land has been claimed as a wear and tear deduction, the Commissioner considers it reasonable that taxpayers add back any wear and tear deductions or balancing deductions claimed for land for a period of three (3) financial years. However, a taxpayer should approach IRD to discuss appropriate action if they are experiencing difficulties in applying the views expressed in this Ruling.

Dated this eighteenth-day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**COMMENTARY**

1 This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in this Ruling. Legislative references are to the Income Tax Act Cap 123 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

**Summary**

2 Subsection 18(2)(c) of the Act which provides that a person shall be allowed a deduction for any deductions provided for by the Act in respect of each year.

The key deductions considered in this Ruling are:

(a) Wear and tear deduction;

(b) General deduction; and

(c) Balancing deduction.

3 The Ruling also considers whether an amount received on the sale of an asset is included in income of the business as a balancing charge.

**Application of legislation**

4 The following provisions are considered in this Ruling:

(a) Section 4(1)(e);

(b) Section 18(1), 18(2)(c), 18(6);

(c) Section 20(1)

(d) Schedule 4

5 This commentary will discuss the specific and general deductions that can be claimed in respect of wear and tear and income to be included in business income.

**Whether land can be subject to a deduction for wear and tear**

6 Land is not specified in the Act or Schedule as a wear and tear deduction. This is because, prima facie, land is not an asset that diminishes in value. A wear and tear deduction is an estimate of the amount by which an asset will reduce in value each year caused by business use. If an asset does not lose any value, it simply does not qualify for a wear and tear deduction. Land is the most common form of an asset that does not lose value. Another example would be a classic or antique motor car. If a classic car is maintained in good working order, its value would not be expected to reduce as it is a collector's item. Similarly, works of art in business premises would not be expected to reduce in value.

7 Furthermore, land does not have a limited effective life to qualify as a capital asset subject to wear and tear and cannot reasonably be expected to decline in value over the time it is in use.

8 An exception to this prima facie rule would be an improvement to land, or a fixture on land such as a building, where it would be recognised as an asset separate from the land.

9 The term "improvement to land" is not defined in the Act or Schedule however the concept of an improvement to land has been widely considered in case law. The principles, that can be extracted from Court cases, provide that an improvement to land is an identifiable alteration to the land that enhances the usefulness of the land to the user.

10 An example of an improvement to land would be an open mine pit where it

enhances the usefulness of the land to a user of the pit. Open pit means the changed configuration of land from its natural state (as it exists from time-to-time), that comes into being through the conduct of an open pit mining operation. It is the gross change to the natural surface of the earth - the pit - that is the identified improvement. An open pit mine site improvement has a limited effective life. A limited effective life is taken to mean there are a limited number of years that an asset can be used to produce income. It is accepted that a pit has a limited income producing life. An open pit mine site improvement is expected to decline in value over the period it is used. Another example would be a dam that improves the value of the land.

11 Structural improvements such as bridges, wharves, shipways as well as roads, driveways and car parks would be subject to a wear and tear deduction similar to buildings.

**Alternative view**

12 An alternative view is that, it has been said, subsection 18(2)(e) of the Act provides a basis under which land could be an allowable wear and tear deduction. The provision allows a deduction for an amount considered by the Commissioner to be just and reasonable as representing the diminution in value of any article, not being machinery or plant in respect of which a deduction may be made under the Fourth Schedule, employed in the production of the income. The Commissioner considers that land in its natural state does not diminish in value in the usual sense.

**Whether lease payments paid for the use of land is an allowable deduction**

13 The Commissioner considers that if land is subject to a lease arrangement, such that an annual lease amount is paid, then this is a deductible expense under the general deduction provision (subsection 18(1) of the Act) where the land is used to derive assessable income. Otherwise, a deduction is not allowable for an annual lease payment or a premium paid for the grant of a fixed term estate of land because of the operation of subsection 20(1) of the Act.

14 A deduction is allowable under subsection 18(2)(i) of the Act if a premium is paid on the grant of a lease of premises or for the acquisition of a fixed term estate lease of land where the Commissioner is satisfied that the land is developed, being developed or will be developed in accordance with a development plan approved by the Commissioner of Lands and the premises or land is used for the purposes of the production of income. The amount of the deduction is the proportion of the period that relates to the full term of the lease. In other words, if the lease is for 10 years and a $100,000 premium is paid, then a deduction of $10,000 would be allowed each year.

**Balancing Deduction and Balancing Charge**

**Vacant land is purchased with a known cost**

15 As the cost of land, either by way of lease or premium, is not deductible if not used to derive assessable income, no balancing charge or balancing deduction is required to be made where vacant land is purchased. If the cost of land has been claimed incorrectly, then an amendment will be required to any returns in which land has been claimed as a deduction to reverse the deduction. For the period for which amendments are required, see the Date of Effect paragraph above.

**EXAMPLE 1**

**No wear and tear deduction is available.**

16. If the land is sold there are no income tax consequences unless a person is carrying on a business of buying and selling land or subdividing land. In this case the income received on such sales would be assessable income and any premium or cost paid for the land would be a deductible expense.

**A lease premium is paid for a lease of premises or a fixed term estate grant**

17 As indicated above, the Commissioner accepts that this is a deductible expense where it is in relation to a lease of premises or fixed term estate used for the purposes of the production of income and the deduction should be made on a straight line basis for the term of the lease. A balancing charge may need to be calculated.

18 If the lease runs its full term, then no balancing charge is necessary as there is no "sale" and the written down value is nil. Also, if it is subleased before the end of the term of the lease, no balancing charge is required to be calculated. This is because rent would be received and there are no sale proceeds.

19 If there was a transfer of a lease of a fixed term estate, the amount received for the transfer of the lease of the fixed term estate minus (the lease premium amount less deductions claimed (if any)) would be a gain amount. The gain would be a non-taxable capital gain and not a balancing charge.

**EXAMPLE 2**

**A lease premium is paid for a lease of premises or a fixed term estate grant**

20 An amortisation straight line deduction is available if the Commissioner is satisfied that the land is developed, being developed or will be developed in accordance with a development plan approved by the Commissioner of Lands and the premises or land is used for the purposes of the production of income.

21 Anthony pays a lease premium for a fixed term estate on which to conduct his business. He is constructing a building on the land in accordance with a development plan approved by the Commissioner of Lands. He pays $100,000. Anthony would be entitled to a deduction of $10,000 for 10 years.

22 Say there is a transfer of the lease before the end of the lease for an amount of $60,000 and:

(a) the lease has run for 4 years then there is no gain or loss – $60,000 minus ($100,000 - $40,000);

(b) the lease has run for 5 years there would be a $10,000 gain ($60,000 minus ($100,000- $50,000) or

(c) the lease has run for 3 years there would be a $10,000 loss to the lessee ($60,000 minus ($100,000- $30,000). Neither gain or loss are assessable or deductible.

**Vacant land is purchased with a building subsequently constructed**

23 Where vacant land is purchased and then a building is subsequently constructed on it, only the original cost of the building can be claimed as a wear and tear deduction at the rate of 5% diminishing value. No revaluation of the building is allowed at any time. Additions to the building, including improvements, can be claimed as a wear and tear deduction. Repairs and maintenance would be claimed as outright deductions in the year of repair or maintenance.

24 The Commissioner considers that if the property is sold as a fixed lump sum for the land and building with no allocation as to the sale price of the components of land and buildings, then, if only the building has been claimed (which is the correct position), the cost/value of the land component on the sale is excluded. The balancing charge or deduction is then worked out on the written down value of the building.

25 On the other hand, if the land and building has been claimed as a single asset, then an amendment to the previous years' tax returns to exclude the cost/value of the land is required. For the period for which amendments are required, see Date of Effect paragraph below. The calculation of the balancing charge or deduction is then based on the written down value of the building.

**EXAMPLE 3**

**Vacant land is purchased with a building subsequently constructed**

26 Casper purchases vacant land at town ground for $1m. He builds a store on the vacant land at a cost of $2m. Casper is entitled to a wear and tear deduction of 5% diminishing value on the cost of the building only. Casper can claim an amortisation deduction for the premium paid for the vacant land.

27 If Casper subsequently sells the land and building, the balancing charge is worked out on the sale price of the building – if the building is sold for $2.5m and the written down value is $1.7m then the balancing charge is $800,000

**Land and building bought as a single property asset**

28 Where land is purchased which includes an existing building, the total cost cannot be claimed as a deduction for wear and tear. If no allocation of land and building has been made at time of sale, then an apportionment must be made for the cost/value of the land at the time of purchase and the remaining value is the

building cost/value which is claimable as a deduction. On a sale of the single asset, again an apportionment is required for the land and building and only the building portion is calculated for balancing charge purposes.

29 The Commissioner considers that it is not just and reasonable, in terms of subparagraph 17(1) of the Fourth Schedule, to use an accountant or taxpayer percentages to split the land and building components. The acceptable practice is to use values or actual costs not percentages. Provided the value is just and reasonable, then the Commissioner will accept the value. As to what is just and reasonable, this should be determined in conjunction with paragraph 21(f) – that is, what the property (land and building as separate components) would have fetched in the open market in an arm's length situation.

30 Similarly, the Commissioner considers using surveyor or valuer percentages to split land and buildings is not a just and reasonable approach. The preferred approach of the Commissioner is to use cost or a value determined by an independent third party, such as valuers approved by the Ministry of Lands Housing and Survey or the relevant Councils in Solomon Islands valuations of the unimproved value of land.

31 The Commissioner appreciates that it is an extra burden on the taxpayer but it should be noted that the cost of obtaining such a valuation can be claimed as a deduction. If no valuation is provided, then the onus is on the taxpayer to justify the split of land and building(s) values to the satisfaction of the Commissioner.

32 A similar apportionment approach needs to be done at the time of sale in order to determine the amount of the sale price attributable to the building. This amount is then used to work out the balancing charge against the written down value of the building.

**EXAMPLE 4**

**Land and building bought as a single property asset**

33 Barnabas purchases a building including land in Kukum. The contract provides that the land is worth $500,000 and the building is worth $750,000. Barnabas is allowed to claim a wear and tear deduction for the building at 5% diminishing value on the cost of the building of $750,000.

34 If the purchase contact does not provide for a breakdown of the cost of the land and building, a valuation will be required to work out the value of the land and the value of the building. Barnabas sells the land and building 3 years later for $2m. with no allocation between the land and building in the contract. In this case, another valuation will be required to allocate the worth of the land and the building at the time of sale.

35 If the valuation shows that the land is valued at $750,000 and the building is valued at $1,250,000, then the gain on the land of $250,000 ($750,000 less $500,000) is not assessable.

36 The excess of the sale value of the building over the written down value is the balancing charge. In this case $1,250,000 is worked out by deducting from the written down value ($643,031).

37 If the land value was $400,000, the loss on the sale value of the land ($400,000 less cost $500,000) is not an allowable deduction. The excess of the $1,600,000 sale value of building over the written down value (643,031) is taxable.

## APPENDIX 1

**Legislation**

All references are to the income Tax Act Cap 123.

Section 4(1)(e) – (1) For the purposes of section 3 (1)(a)(i)

(e) where under the Fourth Schedule it is provided that a balancing charge shall be made, or a sum shall be treated as a trading receipt, for any year, the amount thereof shall be deemed to be gains or profits for such year.

Subsection 18(2)(c) of the Act provides that a person shall be allowed a deduction for any deductions provided for by the Fourth Schedule in respect of each year;

Subsection 18(6) provides that for the purposes of subsection 18(2)(c) the Minister by Order may provide that:

(a) any class of capital expenditure specified in such order shall be the subject of relief under the Fourth Schedule and to the extent provided for in such order;

(b) the amount of any deduction made under the Fourth Schedule shall be varied to such amount as may be prescribed in such order either generally, or in relation to any class of business, or in a particular instance.

Section 20(1) provides that subject to subsections (2), (3) and (4) of section 18, for the purposes of ascertaining the total income of any person for any year, no deduction shall be allowed in respect of:

(a) any expenditure or loss which is not wholly and exclusively incurred by him in the production of the income;

(b) any capital expenditure, or any loss, diminution or exhaustion of capital.

The Fourth Schedule provides in:

(a) paragraph 1, for a wear and tear deduction on capital assets as specified rates;

(b) paragraph 3 the basis as to how to work out the written down value;

(c) paragraph 5 how to work out the balancing charge and balancing deduction; and

(d) paragraph 17 for apportionment of consideration received for the sale of any asset.

# PUBLIC RULING 2024/12

## INCOME TAX: PR 2024/12 INCOME TAX:

## DISTINGUISHING BETWEEN AN EMPLOYEE AND AN INDEPENDENT CONTRACTOR AND THE TAX IMPLICATIONS FOR BOTH

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act Cap 123.

### TAXPAYER PROTECTION

2 This Ruling provides you with the following level of protection:

this Ruling sets out how a tax law applies in relation to a type of person or a type of arrangement.

You can rely on this Ruling (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement in this Ruling turns out to be incorrect because of a Court decision and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

### TAXATION LAWS

3 All legislative references to "the Act" are to the Income Tax Act Cap. 123. This Ruling applies to the section 2 definition of "employee" and "employment" of the Act.

### ARRANGEMENT TO WHICH THIS RULING APPLIES

4 This Ruling sets out the key characteristics of a contract of service, which is an employer/employee relationship and distinguishes these characteristics from that of a contract for services (i.e., an independent contractor).

5 This Ruling applies to:

(a) persons that pay salary, wages, commission, bonuses, allowances or provide any other employment-related income such as benefits to an individual as an employee (whether of the paying person or another person);

(b) individuals engaged as employees and provides guidance as to whether an individual is paid as an employee for the purposes of section 36A of the

Act. That section imposes an obligation on the paying person (employer) to withhold an amount from the relevant payment; and

(c) persons who are independent contractors in business subject to the provisional tax regime, but not independent contractors paying withholding tax.

6 This Ruling does not consider the tax position of persons receiving income from contracting or subcontracting subject to the resident and non-resident withholding tax provisions in subsections 37(2)(a) and 38(3)(d) of the Act.

**HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT**

7 The relationship between an employer and an employee is a contractual one. It is often referred to as a contract of service. An employee contracts to provide their labour to enable an employer to achieve a result.

8 The relationship in paragraph 5 is contrasted with the principal/independent contractor relationship, which is referred to as a contract for services. An independent contractor typically contracts to achieve a result.

9 Common law case law has considered the contractual relationship between the parties in a variety of legislative contexts. As a result, a substantial and well established body of case law has developed various indicia to assist in determining the character of a contracting party.

10 Consideration should be given to the various indicia identified in judicial decisions which have considered the employee/independent contractor distinction, bearing in mind no list of factors is to be regarded as exhaustive and the weight to be given to particular facts will vary according to the circumstances. Where a consideration of the indicia point one way, so as to yield a clear result, the determination should be in accordance with that result.

11 It is rare for a contract with an individual to be anything other than as an employee subject to PAYE Withholding. Indeed, the Commissioner's general experience of these situations in the Solomon Islands, where individuals are providing personal services on a routine basis to one person over a period of time, that, in all but exceptional circumstances, they would be subject to PAYE withholding.

**DATE OF EFFECT**

12 This Ruling applies to years of income commencing both before and after its date of issue. This 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.

Dated this eighteenth-day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

**COMMENTARY**

1 This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Income Tax Act Cap 123 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

3 This commentary will set out the key characteristics of a contract of service, which is an employer/employee relationship and distinguishes these characteristics from that of a contract for services (i.e., an independent contractor).

4 This commentary will then consider the various indicators common law courts have considered in determining whether a person engaged by another individual or person is an employee within the common law meaning of the term.

**SUMMARY**

5 The word "Employee" is defined in section 2 of the Act to mean an individual engaged in employment.

6 The concept of employment is central to the definition of "employee". "Employment" is defined in the Act inclusively so that it otherwise has its common law meaning. An employment relationship, as ordinarily understood, does not include an individual engaged on his or her own account as an independent contractor. An independent contractor is engaged in a business and, therefore, the remuneration derived is business income.

7 Employment is defined broadly and includes office holders and performance under a contract principally for work or services where either the Minister by Order, or the parties voluntarily agree with the Commissioner, that the relationship will be regarded as one of employment for the purpose of the tax deduction provisions. If there is agreement as to an employment contract for tax purposes, it may also have implications in other areas of law.

8 The holding of various offices is treated as employment under the Act. While, in legal form, an office holder is not an employee, there is little difference in substance between the two relationships. In both cases, the remuneration paid is essentially for the labour of the person. Consequently, it is appropriate to treat them as the same for tax purposes.

9 The types of office holders include:

(a) a company director and a person holding or acting in any public office. This means that director's fees and any other remuneration are treated as employment income and subject to PAYE;

(b) other office in the management of a company- such as the holder of an office in the management of an unincorporated association treated as a company for the purposes of the Act;

(c) other types of office holders, such as any position entitling the holder to a fixed or ascertainable remuneration and persons holding or acting in any public office.

**Formation of the contract**

10 In determining the nature of the contractual relationship, it is important to consider all the terms and conditions of the contract between the parties, whether express or implied, in the light of the circumstances surrounding the making of the contract.

11 Contractual arrangements often contain a clause that purports to characterise the relationship between the parties as that of principal and independent contractor and not that of employer and employee. Such a clause cannot be effective according to its terms if it contradicts the effect of the agreement as a whole, that is, the parties cannot deem the relationship between themselves to be something that it is not. The parties to an agreement cannot alter the true substance of the relationship by simply giving it a different label. If the underlying reality of the relationship is one of employment, the parties cannot alter that fact by merely having the contract (or having the worker acknowledge) that the worker's status is that of an independent contractor.

12 For example, an employer may seek to change the status of an employee to that of an independent contractor by both parties signing a contract of engagement that includes a clause to the effect that the worker is an independent contractor rather than an employee. That clause is ineffective if it is inconsistent with the true nature of the relationship inferred from the contract as a whole and the reality of the working relationship. If the terms of the subsisting relationship are not changed, it is likely that the worker's status would remain that of an employee.

13 The circumstances surrounding the formation of the contract may assist in determining the true character of the contract. Thus, if the contract comes into existence because the contractor advertises their services to the public in the ordinary course of carrying on a business, or as a result of a successful tender application, the existence of a principal/independent contractor relationship is more likely. Conversely, if a contract is formed in response to a job vacancy advertisement, or through the services of a placement agency, the existence of an employer/employee relationship is more likely.

**Key elements of employment**

14 The features discussed below have been regarded by the Courts as key indicators of whether an individual is an employee or independent contractor at common law.

15 There are several indicia that have been generally accepted as determinative of an employee/employer relationship. Some are so critical that they are basically conclusive as to the nature of the relationship. There are other indicia which

cannot be seen as conclusively determining the employee/employer relationship and these will need to be considered as part of the broader analysis of the facts of the specific case.

**Provision of Benefits**

16 One of the key elements of an employer/employee relationship is the provision of benefits. The provision of certain benefits is accepted in most cases as a conclusive indicator of such a relationship. In a typical employer/employee relationship, the employer provides a range of benefits which may include, but not limited to sick leave, annual leave, provident fund, leave fares, salary packaging, accommodation and the provision of motor vehicles.

17 An employer may not provide all these benefits. For example, provision of accommodation and motor vehicles may be sufficient to indicate an employment relationship. There is also a high possibility that sick leave, annual leave and leave fares would also indicate the employer/employee relationship.

**Control - Master/Servant relationship**

18 The classic "test" for determining the nature of the relationship between a person who engages another to perform work and the person so engaged is the degree of control which the former can exercise over the latter. A common law employee is told not only what work is to be done, but how and where it is to be done. With the increasing use of skilled labour and the consequential reduction in supervisory functions, the importance of control lies not so much in its actual exercise, although clearly that is relevant, as is the right of the employer to exercise it.

19 The mere fact that a contract may specify in detail how the contracted services are to be performed does not necessarily imply an employment relationship. In fact a high degree of direction and control is not uncommon in a contract for services. The payer has a right to specify how the contracted services are to be performed, but such control must be expressed in the terms of the contract, otherwise the contractor is free to exercise their discretion (subject to any terms implied by law). This is because the contractor is working for themselves.

**Does the worker operate on their own account or in the business of the payer?**

20 The majority of the Australian High Court in Hollis v Vahu (2001) 207 CLR 21 quoted the following statement made by Windeyer CJ in Marshall v Whittaker's Building Supply Co. (1963) 109 CLR 210:

> "The distinction between an employee and independent contractor is 'rooted fundamentally in the difference between a person who serves his employer in his, the employer's business and a person who carries on a trade or business of his own."

The distinction is also referred to as the integration or organisation test.

**Results Contracts**

21 Where the substance of a contract is to achieve a specified result, there is a strong (but not conclusive) indication that the contract is one for services. The words commonly used are "the production of a given result" (*World Book (Australia)* Pty v FC of T (92 ATC 4327)); This phrase means the performance of a service by one party for another where the first party is free to employ their own means (such as third party labour, plant and equipment) to achieve the contractually specified outcome. Satisfactory completion of the specified services is the "result" for which the parties have bargained. The consideration is often a mixed sum on completion of a particular job as opposed to an amount paid by reference to hours worked. If the remuneration is payable when, and only when, the contractual obligations have been fulfilled, the remuneration is usually made for producing a given result.

22 In a contract to produce a result, payment is often for a negotiated contract price, as opposed to an hourly, daily or monthly rate.

23 Having regard to the true essence of the contract, the manner in which the payment is structured will not of itself exclude genuine result based contracts. For example, there are result based contracts where the contract price is based on an estimate of the time and the labour cost that is necessary to complete the task, or may even be calculated on that basis, subject to reasonable completion times.

24 While the notion of "payment for result" is expected in a contract for services, it is not necessarily inconsistent with a contract of service. Accordingly, the contractual relationship as a whole must be considered in order to determine the true character of the relationship between the parties.

**Whether the work can be delegated or subcontracted?**

25 The power to delegate or subcontract (in the sense of the capacity to engage others to do the work) is a significant factor in deciding whether a worker is an employee or independent contractor. If a person is contractually required to personally perform the work that may be an indication that the person is an employee.

26 If an individual has unlimited power to delegate the work to others (with or without the approval or consent of the principal), this is a strong indication that the person is engaged as an independent contractor. Under a contract for services, the emphasis is on the performance of the agreed services (achievement of a result). Unless the contract expressly requires the service provider personally to perform the contracted services, the contractor is free to arrange for their employees to perform some or all of the work or may subcontract some or all of the work to another service provider. In these circumstances, the contractor is responsible for remunerating the replacement worker. This is to be contrasted with a common law employee delegating tasks to other employees. The "delegating employee is not responsible to paying the replacement worker.

**Risk**

27 Where the worker bears little or no risk of the cost arising out of personal injury or defect in carrying out their work, he or she is more likely to be an employee. On the other hand, an independent contractor bears the commercial risk and responsibility for any poor workmanship or injury sustained in the performance of the work. An independent contractor often carries their own insurance and indemnity policies.

**Provision of tools and equipment and payment expenses**

28 The provision of assets, equipment and tools by an individual and the incurring of expenses and other overheads such as his or her own place of work is an indicator that the individual is an independent contractor.

29 However, the provision of necessary tools and equipment is not necessarily inconsistent with an employment relationship. But the provision and maintenance of tools and equipment coupled with payment of business expenses should be significant for the individual to be considered to be an independent contractor.

30 The mere fact that very little or no tools of trade or plant and equipment are necessary to perform the work does not of itself lead to the conclusion that the individual engaged is an employee. The weight or emphasis given to this indicator (as with all other indicators) depends on the particular circumstances, the context and the nature of the contractual work. All the other facts must be considered to determine the nature of the contractual relationship.

31 Further, an employee, unlike an independent contractor, is often reimbursed (or receives an allowance) for expenses incurred in the course of employment, including for the use of their own assets such as their own tools or their car.

**Other common law indicators**

32 In addition to the above, other indicators of the nature of the contractual relationship have been variously stated and have been added to from time to time. Those indicia suggesting an employer-employee relationship include:

(a) the right to suspend or dismiss the person engaged,

(b) the right to the exclusive services of the person engaged,

(c) the provision of benefits such as sick and long service leave and

(d) the provision of other benefits prescribed under an award for employees.

33 However, the fact that a contract does not contain provisions for annual leave and sick leave etc. will not, of itself, be an indicator of a principal/independent contractor relationship.

34 The requirement that a worker wears a company uniform is an indicator of an employment relationship existing between the contracting parties.

35 What the above indicators show is that no one indicia on its own can be taken

as conclusive of an employer/employee relationship, or that of an independent contractor. It is rather determined on a case by case basis. It is therefore vital to assess each individual case according to its facts. In cases where most of the indicators are indicative of an employment relationship, it would most likely be an employer/employee relationship. Alternatively, in cases where the indicators do not support the employer/employee relationship, the relationship would most likely be that of an independent contractor.

**Role of common law criteria in the Act**

36 It is the Commissioner's view that the cases and principles discussed above are a starting point in the determination of whether an individual has been engaged as an employee or as an independent contractor. This is because the term "employment" in the Act has a much wider definition than that prescribed by common law.

37 As stated above, the concept of employment is central to the definitions of "employee" and "employment". Employment is defined broadly and includes office holders and performance under a contract principally for work or services where either the Minister by Order, or the parties voluntarily agree with the Commissioner, that the relationship will be regarded as one of employment for the purpose of the tax deduction provision. Employment also includes any remuneration by way of fees or otherwise for professional services or services as an adviser, consultant manager where such remuneration is paid wholly or substantially for personal services rendered by that person in Solomon Islands.

38 The Explanatory Memorandum to the Income Tax (Amendment) Bill 2005, which introduced the definition of employment into the Act, provides that paragraph (d) of the definition allows the Minister to provide by Order that where performance under a contract is principally for work or services then that relationship will be regarded as one of employment for the purpose of the tax deduction provision.

39 The Minister is able to specify that certain workers, who may in fact meet the tests for an independent contractor relationship but are considered to be 'employee like' in nature, are to be treated as employees for tax purposes. An example where the Minister may make such a determination would be where the contract is for the personal effort and skill of an individual and the individual is expected to bear little business expenditure in providing the services.

40 The Explanatory Memorandum also states that an independent contractor is carrying on a business and therefore, the remuneration derived by the contractor is business income. While there is no single test to determine whether a worker is an employee or independent contractor, the Courts have identified various features of the relationship as a guide to answering the question. Such features include:

(a) The degree of control the payer has as to how the services are carried out:

(b) Whether or not the contract is to achieve a specified result;

(c) The degree of risk borne by the worker; and

(d) Conditions of engagement such as:

(i) The provision of benefits including: annual sick leave; and superannuation;

(ii) Task allocation and control over the timing and scheduling of work;

(iii) Who provides any tools, plant or equipment/facilities necessary to carry out the work;

(iv) Termination of engagement.

41 For the purposes of paragraph (d) of the definition of employment in the Act, the test as set out in the Explanatory Memorandum is whether the person, who is said to be an independent contractor, is considered to be "employee like".

42 Accordingly, there will be instances where an individual could be engaged as an independent contractor under common law principles and still be subject to salary or wages tax in the Solomon Islands. This is particularly the case for individuals who provide professional, advisory, or consultancy services.

43 Employment income is generally treated as Solomon Islands sourced compensation where the individual performs the services while physically located in Solomon Islands irrespective of where it is paid.

**Other Indications**

44 There are some other indications, peculiar to the Solomon Islands, that may assist to determine whether a contracting party is contracting as an independent contractor. Where a person is truly an independent contractor, for example an accountant or lawyer practicing in their own name. Services by such a person would be subject to Sales Tax. Consequently, registration for Sales Tax purposes and the charging of Sales Tax is another indicator that there is an independent business. Thus, it is the Commissioner's view that if the individual performing the work is not registered for Sales Tax, then payments to the individual for work done in Solomon Islands will generally be subject to salary or wages tax.

45 Expatriates carrying on business in the Solomon Islands in their own right would also need to be registered to carry on business for the purposes of the Foreign Investment Act 2005 to be able to obtain a work permit and a working resident visa, or hold a permanent resident visa, to enable them to operate in Solomon Islands as an independent business. Where the individual is not registered with the Register of Foreign Investment, payments to the individual for work done in Solomon Islands will generally be subject to PAYE Withholding.

**Arrangements to Avoid Tax**

46 Section 25 of the Act deals with arrangements purporting to alter the incidence of tax, that is to avoid tax. The word "Arrangement" is defined broadly in subsection 25(5) to mean any contract, scheme, disposition, plan etc. For example, an

arrangement may be to enter into a contract as an independent contractor rather than being employed by a person.

47 Subsection 25(1) of the Act provides that every arrangement made or entered into shall be absolutely void as against the Commissioner for income tax purposes, if and to the extent that, directly or indirectly:

(a) its purpose or effect is tax avoidance; or

(b) where it has two or more purposes or effects, one of its purposes or effects (not being merely an incidental purpose or effect) is tax avoidance, whether or not any other(s) of its purposes or effects relates to, or are referable to, ordinary business or family dealings, whether or not any person affected by that arrangement is a party thereto.

48 The arrangement must have a purpose or effect, directly or indirectly, or where more than one purpose, one of its purposes or effects is tax avoidance.

49 For example, a purpose of an individual entering into a contract for services (independent contractor) rather than of services (employee) to another person, there is also a purpose, albeit it may have been unintentional, that the contractor be subject to the provisional tax system rather than PAYE. This purpose means the contractor is able to claim expenses as deductions thereby reducing its tax payable which it would not be able to do if it was an employee in the PAYE regime.

50 Another example is where a person who is an employee becomes a nonresident and provides services as an independent contractor where the services are the same or similar to those provided whilst an employee. The non-resident would subject to the withholding tax rate of 20%. This has the effect that the ex-employee is not taxed at individual tax rates at PAYE rates (marginal tax rate of 35%). Intention is not relevant it is the effect that matters.

51 Tax avoidance in subsection 25(5) is defined to include "directly or indirectly avoiding, reducing or postponing any liability to income tax. The Commissioner is, of the opinion, that the above arrangement reduces the liability of the ex-employee to income tax because instead of paying tax at personal tax rates, they pay non-resident withholding tax at a lesser rate.

52 Accordingly, the Commissioner contends that the arrangement purporting to reduce the incidence of tax is void. The ex-employee had a choice to be taxed as an individual under the PAYE system or as a non-resident under the withholding tax system. They chose the latter because the tax rate is approximately 20% less.

53 If nothing has changed compared to when they were working in the Solomon Islands prior to the arrangement, then the purpose is to reduce their tax. The avoidance of tax is considered to be an essential feature of the arrangement. (See the High Court of Australia decision in C. of T. v. Gulland, Watson v. FCT and Pincus v. FCT 85 ATC 4765: 17 ATR 1 (the Doctors' cases)). By majority,

the High Court held that former section 260 of the Australian Income Tax Act operated to render the arrangements void for income tax purposes. The majority found that the arrangements were not capable of explanation by reference to "ordinary business or family dealing" without necessarily being labelled as a means to avoid tax, i.e. avoidance of tax was an essential feature of the arrangements. In the course of their decisions the judges in the majority made reference to the following factor that the nature of the income involved in the arrangements, i.e., it was income derived from the personal exertion of each of the medical practitioners.

54 On the question of what is meant by the expression "ordinary business or family dealing", the Court said that the expression is intended to convey the notion of normal or regular rather than common or prevalent. Whilst it might be common for non-resident medical practitioners to enter into a consultancy agreement, it is different in a case where the persons are, say, ex-partners of a Solomon Islands partnership and nothing changed apart from them resigning from the partnership and becoming non-residents. They were being taxed as individuals and the normal position would be that they continue to be taxed as individuals. It is just that the tax arbitrage (tax rate difference - 20% compared to 40%) between the two is significant and the ex-partners chose the nonresident withholding tax regime because it offered a lower tax rate.

55 As stated above, the determination of whether an individual is an employee or independent contractor involves examining a number of indicia (factors), including whether the principal (payer) has the legal right to control the manner in which the work is done and the degree of integration of the activities of the contractor in the business of the principal.

56 In determining the degree of integration, regard is normally had to the following:

(a) whether the contractor is engaged on a continuous basis;

(b) where the services are performed, in particular whether they are performed at the principal's place of business;

(c) whether the principal controls the timing and scheduling of the work;

(d) whether the principal provides the working tools, plant and other relevant facilities necessary for the contractor to perform his or her work.

57 An arrangement between parties that is structured in a way that does not give rise to a payment for services rendered but rather a payment for something entirely different, such as a lease or a bailment, does not give rise to an employment relationship.

58 A key factor in deciding if a worker is an employee is the degree of control that can be exercised over the worker. If the payer has the right to direct how, when, where and who is to perform the work, the worker is likely to be an employee. These directions may be verbal or in writing, or simply understood between the

parties.

59 Another key factor to consider is whether the worker is being paid for the time they work, or being paid for a result. Workers being paid by the hour are more likely to be employees. Workers being paid for a result are more likely to be independent contractors.

60 The main factors to consider in determining whether a worker is an employee or an independent contractor are outlined below and summarised in the table at paragraph 69 below.

61 In the recent High Court of Australia case of *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1, the High Court considered that labels used in a contract by the parties to describe the relationship are not determinative. The High Court majority said that the critical basic question was whether the alleged employee performed the work while working in the business of the engaging entity. The majority also considered that it would be useful to consider whether the worker performed their work in the engaging entity's business or in an enterprise of their own.

62 The Commissioner observes that the High Court majority has not disturbed the well-established practice of examining the totality of the relationship. It considered that the most significant clarification arises in primarily examining the terms of the written contract between the parties to establish the character of the relationship, where that contract is an accurate and accepted record of the agreement struck between the parties.

63 The multi factor test, that requires considering all aspects of the contractual arrangement over an extended period of time, was rejected by the High Court. However, the Commissioner notes that the Judges considered that a Court may look beyond a written contract and consider the conduct of the parties in circumstances where:

(a) the contract is an oral contract, or is partly written and partly oral to determine when the contract was formed and the contractual terms that were agreed;

(b) the terms of the written contract have been varied;

(c) the terms of the written contract are being challenged as invalid (for example, being a sham);

(d) a party to the contract asserts rectification, estoppel or any other legal, equitable or statutory rights or remedies.

64 The long-established employment indicia are still relevant when characterising the contractual relationship between the parties. However, they are to be considered through the focusing question of whether the alleged employee is working in the business of the employer. This reflects the Commissioner's understanding and application of the business integration test. The High Court has elevated

that test as one of the primary and focusing aspects of the examination of the contractual terms. In addition, the High Court has continued the emphasis on the examination of control as a complementary focus to the business integration test.

65 The Australian High Court's commentary that the use of labels in a contract should not be determinative of the nature of a relationship is consistent with existing views of the Commissioner.

**Employee**

66 Generally, a worker is an employee if they:

(a) are paid for time worked;

(b) receive paid leave (for example, sick, annual or recreation, or long service leave);

(c) are not responsible for providing the materials or equipment required to do their job;

(d) must perform the duties of their position;

(e) agree to provide their personal services;

(f) work hours set by an agreement or award;

(g) are recognised as part and parcel of the payer's business; and

(h) take no commercial risks and cannot make a profit or loss from the work performed.

67 ***If a worker is an employee***, the employer payer must withhold an amount from any salary, wages, commissions, bonuses or allowances they pay to the employee. The payer determines the amount to withhold using the tax tables published by Inland Revenue on its website.

**Independent contractor**

68 An independent contractor is an entity (such as an individual, partnership, trust or company) that agrees to produce a designated result for an agreed price. In most cases an independent contractor:

(a) is paid for results achieved;

(b) provides all or most of the necessary materials and equipment to complete the work;

(c) is free to delegate work to other entities;

(d) has freedom in the way the work is done;

(e) provides services to the general public and other businesses;

(f) is free to accept or refuse work; and

(g) is in a position to make a profit or loss.

69 Is the worker an employee or a contractor?

| Factors to consider | Employee | Contractor |
|---|---|---|
| Control over work | The employer has an implied right within industrial law to direct and control the work of an employee. The employee works in the business of the employer and the employer is free to manage their business as they see fit. | A payer has a right to specify how the contracted services are to be performed. However, such control must be specified in the terms of the contract, otherwise the contractor is free to exercise their discretion. |
| Independence | An employee performs work for the employer in accordance with an employment contract. | A contractor performs services as specified in a contract with the payer and provides additional services only by agreement. |
| Payment | Payment is often based on the period of time worked, but an employee can also work on 'piece rates' or commission. | Payment depends on the performance of the contract services. |
| Commercial risks | An employee generally bears no legal risks in respect of the work; since the employee works in the business of the employer, the employer is legally responsible for any work performed by the employee. | A contractor bears legal risk in respect of the work. They have the potential to make a profit or loss, and must remedy any defective work at their own expense. |
| Ability to delegate | An employee performs the work personally and generally cannot subcontract the work to someone else | Unless otherwise specified in the contract, a contractor can subcontract or delegate the work. |
| Tools and equipment | The employer, except when specifically agreed otherwise, usually provides tools and equipment. | Generally, a contractor provides their own tools and equipment. |

**The control test**

70 The control test looks at the degree of control the employer or principal exerts over the work an employee or contractor is to do and the manner in which it is to be done.

71 The greater the extent to which the principal or employer specifies work content, hours, leave and methods, and can supervise, regulate and/or dismiss a person, the more likely it is that the person will be an employee.

72 This test used to be considered as the deciding factor, but this is no longer the case. It is only one of several factors relevant to the interpretation of the contract.

**The independence test**

73 This is the opposite of the control test. A high level of independence on the part of an employee or contractor is inconsistent with a high level of control by an employer or principal.

74 The following factors may indicate that a person has a high level of independence:

(a) work for other people or clients;

(b) work from his or her own premises;

(c) supplies his or her own (specialised) tools or equipment;

(d) has direct responsibility for the profits and risks of the business;

(e) hires or fires (dismisses) whoever he or she wishes to help do the job;

(f) advertises and invoices for the work;

(g) supplies the equipment, premises, and materials used;

(h) pays or accounts for taxes and government and professional levies.

75 On the other hand, when some independent contractors perform work for a principal, they may agree not to work for a competitor or give away trade secrets. This alone will not make the worker an employee (it actually emphasises that the worker is usually entitled to work for others).

76 Also, the fact that a person is contracted to one party only does not, of itself, necessarily mean a conclusion that their legal relationship is one of employment.

**The organisation or integration test**

77 This test is really whether the person is part and parcel of the organisation and not whether the work itself is necessary for the running of the business.

78 According to this test, a job is likely to be done by an employee if it is:

(a) integral to the business organisation;

(b) the type of work commonly done by "employees";

(c) continuous (not a "one-off" or accessory operation);

(d) for the benefit of the business rather than the worker.

**Intention of the parties**

79 This test looks at the intentions of each party to the agreement regarding the nature of the relationship. The description given to a relationship by the parties to the contract is a strong, but not conclusive, indication of the type of relationship that exists. The fact that a written contract states that a person is an employee or an independent contractor may indicate the intention of the parties, but is not decisive. If the actual circumstances point to an employment relationship, then simply labeling it an independent contract or calling the person a consultant will not alter the actuality. If an employment contract treats a person as an employee, for example by paying him or her at regular intervals, at a set rate, and deducting PAYE, this may indicate that there is an employment relationship.

**The fundamental test**

80 The fundamental test for distinguishing an employee and an independent contractor is to ask the question -

> Is the person who has been engaged to perform these services performing them as a person in business on his or her own account?
>
> If the answer to that question is "YES", then the contract is a contract for services and thus the person is an independent contractor;
>
> If the answer is "NO", then the contract is a contract of service and thus the person is an employee.

81 Factors which may be of importance are such matters as:

(a) whether the person performing the services provides their own equipment;

(b) whether he or she hires their own helpers;

(c) what degree of financial risk he or she takes;

(d) what degree of responsibility for investment and management he or she has; and

(e) whether and how far he or she has an opportunity of profiting from sound management in the performance of their task.

82 The fundamental test is also sometimes described as the "business test" or the "economic reality test".

83 The issue that must be settled is:

(a) whether the worker is genuinely in business on his or her own account; or

(b) whether he or she is "part and parcel of" - or "integrated into"- the enterprise of the person or organisation for whom work is performed.

The test is, therefore, one of "economic reality".

84 This test looks at factors such as:

(a) whether the type of business or the nature of the job justifies or requires using an independent contractor;

(b) the behaviour of the parties before and after entering into the contract;

(c) if there is a time limit for completing a specific project;

(d) whether the worker can be dismissed;

(e) who is responsible for correcting sub-standard work;

(f) who is legally liable if the job goes wrong.

85 Usually, an independent contractor agrees to be responsible for his or her work. He or she cannot usually be "dismissed", although the contract can be terminated if it is broken.

## APPENDIX 1

## EXAMPLES

**Haus-Meri – Employer/Employee**

| Facts | Application of the Law to the Facts |
|---|---|
| • Rachael works for Mr John Wesley as a housekeeper | • Although Rachael and Mr. Wesley attempt to recast the relationship as a private contractor with Rachael provide her own tools of trade, she is an employee. |

| | |
|---|---|
| • Mr Wesley is an expatriate who is contracted by Solbrew Limited as a consultant. His wife is also a teacher and she is engaged on a voluntary basis to teach at Woodford International School.<br>• Both of them are very busy and do not have the time to clean and keep the house tidy.<br>• Mr Wesley engages Rachael to do his house-keeping and pays her $1,400SBD on a fortnightly basis. He tells her to come in at 8am in the morning and finish at 3pm in the afternoon<br>• She is required to work a total of 7 hours each weekday Monday to Friday and 3 hours on weekends.<br>• Mr Wesley asks Rachael if she can bring along her own broom, mop and bucket to do the work.<br>• Mr Wesley provides a schedule of jobs which Rachael must complete on a regular basis. Rachael is required to personally perform these services and is not able to delegate these tasks. Her work is regulated and controlled.<br>• Mr Wesley has exclusive right to Rachael's time and services from 8am until 3pm.<br>• Mr Wesley also has the right to fire or suspend her.<br>• Mr Wesley is told by IRD that Rachael is an employee and that he will be required to register with the IRD, deduct and remit PAYE tax and fulfil other tax obligations as an employer.<br>• Mr Wesley pays Rachael's NPF contributions each month to SINPF. | • It is clear that the arrangement is wholly or substantially for the labour of the person to whom the payments are made.<br>• Rachael is subject to a high degree of control by Mr Wesley in her work and would remain as a common law empoyee in any event.<br>• Mr Wesley will be required to register for PAYE tax, deduct tax from Rachael's wages and remit it to IRD. |

## Brick Layer - Sub-Contractor

| Facts | Application of the Law to the Facts |
|---|---|
| • George is contracted by Honiara City Council ("HCC") to construct a sea wall at Lela Beach to control the sea and redirect it in a certain way so a children's playground can be erected.<br>• The sea wall is to be 40 metres long and 1 metre high. George is to complete the sea wall before the end of December in time for the students vacation so they can enjoy the park.<br>• The chairman of HCC does not check on George regularly.<br>• The contract can only be terminated if there is a serious breach of the substantive provisions.<br>• George engages Casper and Eric to help him. He gives each of them a 20 meter segment of the sea wall to build.<br>• They are required to provide their own cement mixers, tools, sand, gravel and cement powder. (The rocks have been provided by George to ensure a consistent look for the entire sea wall).<br>• Casper and Eric also engage their own labourers to mix the cement and carry the rocks for them. George does not regulate their hours or manner of work, provided they are making consistent progress towards completion of their segments by the end of December. | • George is a contractor to HCC and payments made to him under the contract will not be subject to PAYE Withholding.<br>• The payments to George will be "Business Income"<br>• HCC will need to register for Withholding Tax and withhold 7.5% of the payment to George as Income form contracting unless he can provide a valid exemption letter that he is paying provisional tax.<br>• Casper and Erick will each be sub-contracted to George.<br>• George will also need to comply with the provisions of the Withholding Tax Provision.<br>• George has to register with the IRD withold and remit to IRC 7.5% of the payments under the contract unless Casper and Eric can each provide an exemption letter showing each of them is payming provisional Tax.<br>• Casper and Eric will in trun each be employers of the labourers who are assisting them and will be required to fulfill the obligations of an employer set out above. |

## Management Consultant – Non-Resident Contractor (Withholding) Tax

- **Facts**
- The newly established Commercial Bank of Solomon Islands has entered into a contract with Data Systems Ltd a company from Australia.
- Data Systems Ltd has offered to provide the services of Mr David Smith, a specialist database consultant.
- Data Systems Ltd has agreed to provide the methodologies which are likely to have the best prospects for long-term viability and standards acceptance, whilst being supportable in the relatively isolated Solomon Islands environment.
- He recommends a cost-effective upgrade path to be taken by the Bank to replace current programming development tools. He also prepares a detailed implementation plan for the upgrade/conversion project.
- Furthermore, Mr Smith supervises and monitors the project up to the point where the local information technology (IT) staff are able to sustain it.
- Mr Smith also investigates and recommends database systems documentation tools and supervises and monitors their initial adoption and implementation. Finally, he trains the Bank's IT staff to use the new development tools, languages, database administration and use of database systems documentation tools.
- Mr Smith's services require a high level of technical expertise. He is very competent and has the knowledge in this area of information technology. Because of that, he is the only one able to provide those services to the Bank.
- The contract requires Data Systems to provide a total of 40 weeks of service of the Consultant during the Consultancy period
- The services are to be provided in Honiara, unless otherwise agreed by the Data Systems Ltd and the Bank.
- Data Systems Ltd is required to diligently and efficiently carry out or procure the performance of the services as agreed to in the contract and comply with the reasonable directions of the Bank.
- Data Systems Ltd is able to sub-contract the services or performance of the services without the prior written approval of the Bank and attempts to do so in its agreement with Mr Smith by simply signing an agreement with Mr Smith which states that he is an independent contractor.

- **Application of the Law to the Facts**
- Data Systems Ltd will be a non-resident contractor and Mr. Smith will be an employee of the Bank.
- 
- The contract between Data Systems Ltd and the Bank will be one of providing professional services since it relates to the "provision in Solomon Islands of professional servides or services as an adviser, or consultant" and all payment by the Commercial Bank of Solomon Islands to company will be submect to withholding tax at 20%.
- The Bank will need to provide a copy of the contract ot the IRD for review and subsequently register with the IRD for non-resident withholding tax and withhold 20% tax from any c ontract payments and rdmit these to the IRD.
- Although not an employee of the Bank, Mr Smith who is engaged byData System Ltd will be subject to the salary or wages tax regime regardless of his attempt to be seen as sub-contractor to Data System.
- Even if Mr Smith is not considred to be an employee under common law rules, (perharps due to his high technical skill, the limited supervision and control by Data Systems Ltd and the prcise terms of his contract), he will still be subject to salary or wages tax in the Solomon Islands. this is because of the extemely broad definition of employment in Solomon Islands which includes, "any remuneration by way of fees or otherwise for professional services as an adviser, consultant,.. where such remuneration is paid wholly or substantially for personal services rendered by that person in Solomon Islands.
- Data Systems Ltd, even though a non-resident must also register for PAYE and remit PAYe withholding to the IRD that has been deducted from the salary paid to Mr Smith whilst he works in Solomon Islands.

## Non-Resident - Fly- In Fly- Out Employee

### Facts

- Mr Thomas Davidson is an expatriate who is an engineer by profession.
- He is contracted by Blue Mountain Mining Ltd, a mining and exploration company registered in Solomon Islands
- His family resides in Brisbane, his home.
- His contract with Blue Mountain Mining is such that he works for 2 weeks at the mine site and takes 2 weeks break.
- He goes back to Brisbane to be with his family for 2 weeks every 6 weeks.
- After his two weeks break he returns to Blue Mountain company in Solomon Islands.

### Application of the Law to the Facts

- Mr Thomas Davidson is an employee subject to PAYE in Solomon Islands. He would be a manager or a consultant.
- His income is tazablein Solomon Islands because his income is sourced from within Solomon Islands.
- Mr Davidson salary is from work he did in Solomon Island and his source of income is in Solomon Islands.
- Mr Thomas Davidson is subject to tax in Solomon Islands on teh entirety of his income received form Blue Mountain.
- Mr Davidson's income is therefore tazable on both the 4 weeks working period and the 2 week break, because the payment for the two weeks is as a result of the work he undertakes whilst in Solomon Islands which remain the source regardless of the fact that he may be in Australia for 2 weeks when it is actually received.

| | |
|---|---|
| • He is paid on a fortnightly basis. He is advised by his employer that his salary is taxable only on the 4 weeks that he is working in the Solomon Islands. He is further advised that the income earned overseas when he is on his field breaks is not taxable in Solomon Islands | |
| **Solomon Islands Company with Sole Employee** | |
| **Facts** | **Application of the Law to the Facts** |
| • Mr Steven Gagma is a highly paid economist working for F Ltd. After a discussion with their Human Resources division, it was agreed that Mr Gagma would resign from the company on the following Friday, but would consult back to the company in a similar capacity to his current role through his own company (M Ltd).<br>• Mr Gagma incorporated a new company (M Ltd) and appointed himself and his brother as directors and his wife as the company secretary. Mr Gagma's wife works 40 hours per week and personally performs all economic analyses required under the contract. F Ltd pays M Ltd $350,000SBD annually under the contract.<br>• This new arrangement would enable Mr Gagma to increase his take home pay by "employing" various family members in his company, thereby reducing his tax at no additional cost to F Ltd.<br>• M Ltd purchases a house for Mr Gagma and his extended family.<br>• The company pays $100,000SBD annually to his wife and $70,000SBD to his brother.<br>• Mrs Gagma prepares a fortnightly invoice from M Ltd to F Ltd and her brother-in-law occasionally collects or delivers documents for their company. | • Mr Steven Gagma will be treated as an employee of F Ltd for Solomon Islands tax purposes.<br>• The remuneration received by M Ltd is remunerated by way of fees for professional services, or services as an adviser, consultant etc. and is paid substantially for personal services rendered by Gagma himself and therefore fall within the definition of employment.<br>• The fact that he cannot delegate tasks and works from the premises of F Lted further establishes his position as an employee for tax purpose.<br>• The manner in which M Ltd was establishec and the consultancy contract awarded indiates that this is a tax avoidance arrangement to which section 25 would apply. All of the various contractual arrangements will be ignored for tax purposes and F Ltd may, in addition, be subject to penalties.<br>• Further, the lack of any substantial role in the company by his wife and brother indicate that their employment with M Ltd is little more than a sham.<br>• Even if M Ltd was registered for Sales Tax and obtained an exemption letter, FLtd on a full time basis, actively pursued a number of other clients, was registered for Sales Tax, exemption letter and was not involved is such blatant income splitting then the Commissioner would usually accept the arrangements at face value. |

## APPENDIX 2

### Legislation

All references are to the income Tax Act Cap 123.

The application of the following sections of the Act are considered in this Ruling:

Section 2(1) "In this Act, unless the context otherwise requires:

"***employee***" means an individual engaged in employment;

"***employer***" means a person who engages or remunerates an employee;

"***employment***" includes:

(a) a directorship or other office in the management of a company or body of persons;

(b) a position entitling the holder to a fixed or ascertainable remuneration;

(c) the holding or acting in any public office;

(d) performance under a contract principally for work or services where the Minister provides by Order that the relationship will be regarded as one of employment for the purpose of the tax deduction provision; or

(e) performance under a contract principally for work or services where the

parties voluntarily agree with the Commissioner that the relationship will be regarded as one of employment for the purpose of the tax deduction provision;

"***employment income***" means gains or profits from employment as determined under section 5 of the Act.

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**PUBLIC RULING**
Section 149

**PUBLIC RULING 2024/13**

## INCOME TAX: TAX OBLIGATIONS OF LANDLORDS AND TENANTS IN RESPECT OF RENTAL INCOME DERIVED FROM THE LEASE OF PROPERTY IN THE SOLOMON ISLANDS

1 This publication is a Public Ruling made under section 149 the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act Cap 123.

### TAXPAYER PROTECTION

2 This Ruling provides you with the following level of protection: this Ruling sets out how a tax law applies in relation to a type of person or a type of arrangement.

You can rely on this Ruling (excluding appendices) to provide you with protection from interest and penalties in the way explained below. If a statement in this Ruling turns out to be incorrect because of a Court decision and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

### TAXATION LAWS

3 All legislative references to "the Act" are to the Income Tax Act CAP 123.

### ARRANGEMENT TO WHICH THIS RULING APPLIES

4 This Ruling sets out:

(a) the tax treatment of rental income under the Income Tax Act Cap 123 (the Act);

(b) the methods for deducting withholding tax from rental income where the payee (landlord) is a resident or non-resident of Solomon Islands for tax purposes;

(c) the criteria and consequences of treating resident and non-resident

withholding tax on rental income as a final tax;

(d) the consequences if tenants do not deduct resident withholding tax (RWT) from rental payments where the resident landlord does NOT hold a letter of RWT exemption;

(e) the options for taxing gross income from lease of property for both resident and non-resident landlords; and

(f) the conditions for rent to be deductible expenditure for income tax purposes of the tenant.

5 The class of person this Ruling applies to are landlords and tenants.

**HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT**

6 Income from the lease of property (commonly called rental income) is one form of income that is subject to withholding tax. Withholding tax is imposed on residents and non-residents receiving rental income.

7 Resident withholding tax (RWT) is applied in accordance with subsection 37(2) of the Act and is at the rate of 10% of the gross rental income. Gross rental income includes any amount received by the landlord for utilities or security and any other amounts to be paid by the landlord from the amount paid by the tenant as agreed between the landlord and tenant.

8 RWT on rental income has been a final tax since January 2006 for a resident individual landlord when correctly deducted, regardless of whether the landlord derives other income in a tax year, but not for non-individual landlords such as companies, partnerships and trusts or for other body of persons as defined in the Act.

9 The method by which a resident individual landlord's income tax obligation in relation to rental income is met is to have withholding tax deducted from the gross rental payments by the tenant and remitted to IRD as required under section 37 of the Act.

10 RWT that is deducted from rental income by the tenant is a final tax to a resident individual landlord if the following 3 criteria are satisfied;

(i) The correct amount of RWT has been deducted; and

(ii) RWT that has been correctly deducted has been remitted to IRD; and

(iii) The landlord is a resident individual.

11 The following 3 consequences apply to the landlord if the RWT is a FINAL tax:

(i) The rental income is not be taken into account in calculating the total income of the resident individual landlord; and

(ii) No deduction will be allowed in respect of any expenditure incurred in deriving the rental income; and

(iii) If the only income derived by the landlord for the year is the rental

income, the landlord is not required to file an income tax return unless otherwise required to under section 37 of the TAA, (previously section 57(2) of the Act), for example, the Commissioner issues a notice to file a return.

12 Where the tenant fails to deduct withholding tax as required, the CIR may recover the tax (not exceeding the tax that should have been deducted) from the landlord, however, the tenant is still liable for:

(a) any legal action taken in relation to the failure;

(b) any penalty or additional tax in respect of the failure; and

(c) further, a tenant in business will not be allowed a deduction for the expenditure to which the failure relates under section 20(2A). (see section 38C(2)(c) of the Act).

13 There are two methods under subsection 37(1) of the Act by which a resident non-individual landlord can meet their instalment of income tax obligation in respect of rental income derived.

(a) Method 1 - the most common method to meet a resident landlord's instalment of income tax obligation in relation to rental income is to have withholding tax deducted from the gross rental payments by the tenant and remitted to IRD as required under section 37.

(b) Method 2 - the other method is to obtain a yearly exemption letter from the Commissioner from the provisions of section 37. If a resident non-individual landlord wants to use Method 2, that is to not have RWT deducted during the year and to pay provisional tax instead, they must submit a written application to IRD requesting exemption from RWT. Subject to the approval of IRD, they can then meet their instalment of income tax obligation through paying provisional tax. Under both methods, it is not a final tax. The resident non-individual landlord is required to file an income tax return and pay the balance of any income tax payable at the appropriate rate in addition to any other income and can claim either the 10% RWT or provisional tax paid as a credit.

14 From 1 March 2018, non-resident withholding tax (NRWT) applies to income from lease of property paid to non-resident landlords at 10% and is a final tax of the non-resident landlord for both individuals and non-Individuals, if the correct amount of RWT has been deducted; and the NRWT that has been correctly deducted has been remitted to IRD. If the non-resident landlord has other sources of Solomon Islands income such as business income, then the non-resident is required to file an income tax return and depending on whether they have a permanent establishment can claim the NRWT as a tax credit, except for non-resident individual landlords.

15 Whether a non-resident landlord conducting a business is operating through a

permanent establishment depends on the answer to the following question:

*Whether the non-resident landlord has an agent who habitually exercises a general authority to negotiate and conclude contracts on behalf of the nonresident landlord?*

(Examples of such agents include but not limited to, a real estate agent, a lawyer, or tax agent).

16 If the answer is YES, a non-resident landlord will be treated as a resident for tax purposes and the non-resident landlord is required to file an income tax return and include the rental income and can claim a credit for any tax deducted by the tenant and paid to the Commissioner.

17 If the non-resident landlord is an individual then Section 40A of the Act will apply to the rental income being a final tax if all the criteria in paragraph 10 for a final tax are met, and only taxed on other sources of income.

18 If the answer is NO, then, provided the tenant has correctly deducted the NRWT and paid the tax to the Commissioner, the NRWT is a final tax for both non-resident individual and non-individual landlords.

19 When making a rental payment to either a resident or non-resident landlord, a tenant is required to deduct RWT or NRWT of 10% from the gross payment and remit the RWT or NRWT to IRD no later than the 15th day of the following month.

20 In the case where RWT or NRWT is not deducted or incorrectly deducted, sections 38B and 38C of the Act apply. If a person (tenant) fails to deduct RWT, or deducts but fails to remit it to IRD, they are personally liable to pay to the Commissioner (CIR) the amount of tax, and any penalty or additional tax due in respect of the failure (section 38B).

21 Where the tenant fails to deduct withholding tax as required, the CIR may recover the tax (not exceeding the tax that should have been deducted) from the landlord, however, the tenant is still liable for:

(a) any legal action taken in relation to the failure;

(b) any penalty or additional tax in respect of the failure; and

(c) further, a tenant in business will not be allowed a deduction for the expenditure to which the failure relates under section 20(2A) (see section 38C(2)(c) of the Act).

22 Tenants who are conducting a business from the rented premises can claim the rent that they pay as a deductible expense in their own income tax return.

23 For business tenants to be eligible to claim rent as a deductible expense they must deduct the correct amount of RWT or NRWT from every rental payment;

and pay to IRD the correct amount of RWT or NRWT that has been deducted no later than the 15th day of the following month.

**DATE OF EFFECT**

24 This Ruling applies to years of income commencing both before and after its date of issue. This 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.

Dated this eighteenth-day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**COMMENTARY**

1 This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Income Tax Act Cap 123 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

3 This commentary will set out the:

(a) the tax treatment of rental income under the Income Tax Act Cap 123 (the Act);

(b) the methods for deducting withholding tax from rental income where the payee (landlord) is a resident or non-resident of Solomon Islands for tax purposes;

(c) the criteria and consequences of treating resident and non-resident withholding tax on rental income as a final tax;

(d) the consequences if tenants do not deduct resident withholding tax (RWT) from rental payments where the resident landlord does NOT hold a letter of RWT exemption;

(e) the options for taxing gross income from lease of property for both resident and non-resident landlords; and

(f) the conditions for rent to be deductible expenditure for income tax purposes of the tenant.

**SUMMARY**

**Background**

4 Income from the lease of property (commonly called rental income) is one form of income that is subject to withholding tax. One reason why it is subject to

withholding tax is as a means of collecting tax of a landlord throughout the year, similar to provisional tax.

**History**

5 RWT was first applied to income derived for the year ending 31st December 1990. RWT is applied in accordance with subsection 37(2) of the Act and is at the rate of 10% of the gross rental income. RWT on rental income has been a final tax since January 2006 for a resident individual landlord (but not for non-individual landlords such as companies, partnerships and trusts or for other body of persons as defined in ACT), when correctly deducted, regardless of whether the landlord derives other income in a tax year.

6 In accordance with a Ministerial Order effective from 1 March 2018, nonresident withholding tax (NRWT) applies to income from lease of property paid to non-resident landlords at 10%.

7 All NRWT on income paid to non-residents that is listed in section 38 of the Act is a final tax.

8 When rental income is derived from the lease of property by a resident taxpayer of Solomon Islands, that rental income is subject to RWT pursuant to section 37. The rate of RWT is 10% (the rate specified in the Seventh Schedule) of the gross rental income. Gross rental income includes any amount received by the landlord for utilities or security and any other amounts to be paid by the landlord from the amount paid by the tenant as agreed between the landlord and tenant.

**Resident Individual Landlord**

9 The method by which a resident individual landlord's income tax obligation in relation to rental income is met is to have withholding tax deducted from the gross rental payments by the tenant and remitted to IRD as required under section 37. The tax withheld is a final tax.

**Resident Non-individual Landlord**

10 There are two methods under subsection 37(1) of the Act by which a resident non-individual landlord can meet their instalment of income tax obligation in respect of rental income derived.

(a) Method 1 - The most common method to meet a resident landlord's instalment of income tax obligation in relation to rental income is to have withholding tax deducted from the gross rental payments by the tenant and remitted to IRD as required under section 37.

(b) Method 2 – the other method is to obtain an exemption from the provisions of section 37. If a resident non-individual landlord wants to use Method 2, that is to not have RWT deducted during the year and to pay provisional tax instead, they must submit a yearly written application to IRD requesting exemption from RWT. Subject to the approval of IRD, they can then meet

their instalment of income tax obligation through paying provisional tax.

11 Under both methods, it is not a final tax. The resident non-individual landlord is required to file an income tax return and pay the balance of any income tax payable at the appropriate rate and can claim either the 10% RWT or provisional tax paid as a credit.

**What must a tenant do?**

12 When making a rental payment to either a resident or non-resident landlord, a tenant is required to deduct RWT or NRWT of 10% from the gross payment and remit the RWT or NRWT to IRD no later than the 15th day of the following month.

The tenant is required to complete and submit an original Withholding Tax Monthly Summary Form to IRD at the same time as the payment. The tenant is also required to make two copies of the Form. These copies of the Form are stamped by IRD – one copy must be given to the landlord and one copy kept by the tenant. Copies may be scanned copies or photocopies.

13 In the case where RWT or NRWT is not deducted or incorrectly deducted, sections 38B and 38C of the Act apply. If a person (tenant) fails to deduct RWT, or deducts but fails to remit the RWT to the IRD, they are personally liable to pay to the Commissioner (CIR) the amount of tax, and any penalty or additional tax due in respect of the failure (section 38B).

14 Where the tenant fails to deduct withholding tax as required, the CIR may recover the tax (not exceeding the tax that should have been deducted) from the landlord, however, the tenant is still liable for:

(a) any legal action taken in relation to the failure;

(b) any penalty or additional tax in respect of the failure; and further, a tenant in business will not be allowed a deduction for the expenditure to which the failure relates under section 20(2A)[6]. (see section 38C(2)(c) of the Act).

**Resident Withholding tax that is a Final Tax**

15 RWT that is deducted from rental income by the tenant is a final tax to a resident individual landlord if the following 3 criteria are satisfied;

(i) The correct amount of RWT has been deducted; and

(ii) RWT that has been correctly deducted has been remitted to IRD; and

(iii) The landlord is a resident individual.

**EXAMPLE 1**

16 Mr. A arrives in the Solomon Islands from overseas to work for a Non-Governmental Organisation (NGO) which delivers health programs locally. He rents an apartment from a Mrs. B, an individual who is a resident of the Solomon

6 *See footnote 2*

Islands for tax purposes.

17 In the first year he is a tenant, Mr. A does not deduct tax from the rent he pays. At the end of the year Mrs. B must lodge an income tax return, return the gross income and can claim deductions against the rental income.

18 In the second year, Mr. A becomes aware of his obligation to deduct 10% tax, which he does, but he does not pay the amount to IRD. Mrs. B must lodge an income tax return, return the gross income and can claim deductions against the rental income.

19 In the third year, Mr. A becomes fully aware of all his obligations, so deducts 10% tax and pays it to IRD by the 15th day of the next month. Mrs. B does not have any other income other than the rental income, so she is not required to lodge an income tax return. The withholding tax deducted is a final tax for Mrs. B.

20 The following 3 consequences apply to the landlord if the RWT is a FINAL tax:

(a) The rental income is not be taken into account in calculating the total income of the resident individual landlord; and

(b) No deduction will be allowed in respect of any expenditure incurred in deriving the rental income; and

(c) If the only income derived by the landlord for the year is the rental income, the landlord is not required to file an income tax return unless otherwise required to under section 37 of the TAA, (previously section 57(2) of the Act), for example, the Commissioner issues a notice to file a return.

**Resident Withholding Tax that is NOT a final tax**

***Resident Individual Landlord with Rental Income Only***

21 If the rental income is the only source of income, the individual landlord is not required to file an income tax return. This applies even if the individual receives rental income from more than one property, provided the three criteria listed above in paragraph 14 are met in respect of each property.

22 However, if:

(a) no RWT has been deducted; or

(a) has been incorrectly deducted; or

(a) RWT has been deducted, but not paid to the CIR by either the tenant or the individual landlord, the RWT is not a final tax in accordance with section 40A. Accordingly, the individual landlord is required to file an income tax return as subsection 40A (3) does not apply. The tax consequences are as per ii and iii in the table at paragraph 23 on the next page.

***Resident Individual Landlord with rental income as well as other sources of income***

23 This table sets out the tax consequences of a resident individual landlord who has rental income as well as other sources of income which has not had final withholding tax deducted such as PAYE.

| | | Is an Income Tax Return to be filed? | Is the Rental Income required to be disclosed In the income tax return? | Are the expenses relating to Rental Income deductible? | Should the RWT deducted be off-set against income tax liability? |
|---|---|---|---|---|---|
| i | RWT correctly deducted and remitted to IRD | Yes | No | No | No |
| ii | RWT incorrectly deducted | Yes | Yes | Yes | Yes (the amount deducted) |
| iii | RWT not deducted | Yes | Yes | Yes | N/A |

***Note:***

*The above scenarios can also apply if the individual landlord has more than one property. However, the final tax consideration should be applied on a property by property basis and the 3 criteria in paragraph 15 must be met in respect of each property.*

### *Resident Non-Individual Landlord with Rental Income plus Other Sources of Income*

24 The table below sets out the tax consequences for a resident non-individual landlord with rental income as well as other sources of income. The following table applies where no letter of RWT exemption has been issued to the landlord.

| | Is an Income Tax Return required to be filed? | Is the Rental Income required to be disclosed in the income tax return? | Are the expenses relating to Rental Income deductible? | Should the RWT deducted be off-set against income tax liability? |
|---|---|---|---|---|
| RWT deducted correctly or incorrectly or not deducted | Yes | Yes | Yes | Yes (if RWT deducted) |

25 If the landlord is a non-individual, they must declare their rental income and related expenses in their end of year income tax return together with any other income.

26 A non-individual landlord must disclose their rental income in their tax return even if the correct withholding payments have been deducted throughout the year and paid to the IRD. If RWT has been deducted and paid to IRD it will be allowed as a credit against the company tax to be paid. If the non-individual landlord has no end of year tax obligation, they will be entitled to a credit against the following year's tax obligation or a refund.

### *Provisional and final (end of year) tax*

27 If a resident non-individual landlord wants to pay provisional tax instead of having RWT deducted, they must submit a written application to IRD yearly requesting exemption from RWT. Subject to the approval of IRD, they can then meet the instalments of their income tax obligation through paying provisional

tax. This alternative payment option is provided under the second proviso of subsection 37(1) of the Act.

28 If approved, the IRD will issue a letter to the landlord to provide to the tenant as evidence that the tenant is not required to deduct RWT from the rental payments. The tenant must continue to deduct RWT, unless a current year IRD letter of RWT exemption is provided by the landlord.

29 The landlord who is approved for this payment method by IRD can then meet their instalments of income tax obligation through paying provisional tax during the year, filing an end of year income tax return and paying income tax on 30th September of the following year. The landlord will be required to declare all rental income and can claim related deductible expenses

**Non-resident Landlord**

***No Permanent Establishment***

30 Income from the lease of property derived by a non-resident landlord is subject to non-resident withholding tax (NRWT) in accordance with section 38(3)(j) of the Act.

31 The NRWT is a final tax, for both individuals and non-Individuals, if the correct amount of RWT has been deducted; and NRWT that has been correctly deducted has been remitted to IRD. If the non-resident landlord has other sources of Solomon Islands income such as business income then the nonresident is required to file an income tax return and depending on whether they have a permanent establishment can claim the NRWT as a tax credit, except for non-resident individual landlords.

32 If NRWT has not been deducted correctly and/or not paid to IRD, paragraph 18 above applies.

**Permanent Establishment**

33 Whether a non-resident landlord conducting a business is operating through a permanent establishment depends on whether the following question:

*- whether the non-resident landlord has an agent who habitually exercises a general authority to negotiate and conclude contracts on behalf of the nonresident landlord?*

(Examples of such agents include but not limited to, a real estate agent, a lawyer, or tax agent).

34 If the answer is YES, the non-resident landlord will be treated as a resident for tax purposes and the non-resident is required to file an income tax return[7]. Section 40A of the Act will apply to the rental income being a final tax if all the criteria for a final tax as set out in paragraph 15 are met.

7 *Note: Only registered tax agents can file an income tax return on behalf of a non-resident if they charge a fee*

**Example 2 - Mr. C who lives in Brisbane**

35 G Corporation, a resident of Australia, rents out a house in Honiara. It uses a real estate agent in Honiara to manage the property. Every time a new lease is signed with a tenant, the lease agreement says that G Corporation will pay the withholding tax on behalf of the tenant from the gross amount paid by the tenant.

36 Since 1 January 2023, G Corporation has engaged a registered tax agent to file monthly Withholding Tax Monthly Payment Summary form and two copies and pay the 10% tax.

37 G Corporation is considered to have a permanent establishment in the Solomon Islands because of the real estate agent and tax agent. G Corporation must lodge tax returns in the Solomon Islands as it is deemed to be a resident and declare the rental income. This is the case even though normally the 10% withholding tax is a final tax for a non-resident company on the rental income.

**Tax implications for a Payer (tenant) of a resident or non-resident landlord**

38 Tenants who are conducting a business from the rented premises can claim the rent that they pay as a deductible expense in their own income tax return.

39 Former Subsection 20(2A) now section 20(2B) of the Act provides that rent is deductible expenditure of a tenant conducting a business provided that the correct amount of RWT or NRWT has been deducted and remitted to IRD together with Form.

40 For business tenants to be eligible to claim rent as a deductible expense they must:

(i) deduct the correct amount of RWT or NRWT from every rental payment; and

(ii) pay to IRD the correct amount of RWT or NRWT that has been deducted no later than the 15th day of the following month.

**EXAMPLE 3**

41 ABC Pty Ltd rents a shop from DEF Pty Ltd to conduct a trading business for $10,000 per month, which includes $9,000 for rent and $1,000 for water and electricity.

42 ABC Pty Ltd deducts $1,000 tax per month (10% of $10,000) and pays it to IRD by the 15th day of the next month with a Withholding Tax Monthly Payment Summary form and two copies.

43 As a resident company DEF Pty Ltd will lodge their annual income tax return and include $120,000 as gross rental income. It can deduct any expenses related to the rental income such as water and electricity. DEF Pty Ltd will get a tax credit for $12,000 withholding tax deducted. ABC Pty Ltd can claim a tax deduction for $120,000 rent paid.

44 Section 38B of the Act provides that persons (tenants) who fail to deduct and pay RWT or NRWT are personally liable to pay to the CIR the amount of RWT or NRWT, any penalty, and additional tax due in respect of the failure unless the landlord has produced a letter from the IRD of exemption from RWT or NRWT.

45 Alternatively, under section 38C of the Act, when a tenant fails to deduct RWT or NRWT where no letter of exemption has been produced, the Commissioner may recover the tax (not exceeding the tax that should have been deducted) from the landlord.[8]

46 However, even if the outstanding tax is collected from the landlord, the tenant is still liable for:

i. any legal action in relation to the failure to deduct and pay and

ii. any penalty or additional tax in respect of the failure.

47 In addition, any deduction for the expenditure to which the failure relates will be disallowed under section 20(2B) (formerly 20(2A) of the Act) until the correct tax required to be deducted has been paid to the Commissioner or an exemption letter produced.

**Tax Implications for the Payee (Landlords)**

*In cases where RWT is a FINAL TAX*

48 In this situation:

(a) Rental income and related expenses should not be included in the landlord's income tax return where a return is separately required; and

8 *IRD can either recover the unpaid RWT from tenant under s38B of the ACT or from the landlord under s38C of the Act but not from both as it would be a double recovery.*

(b) RWT paid in respect of the rental income will not be credited in the income tax assessment.

*In cases where RWT is not a FINAL TAX*

49 In this situation:

(a) The rental income and related expenses should be included in the landlord's income tax return; and

(b) RWT correctly deducted by the tenant will be credited against the landlord's final income tax liability.

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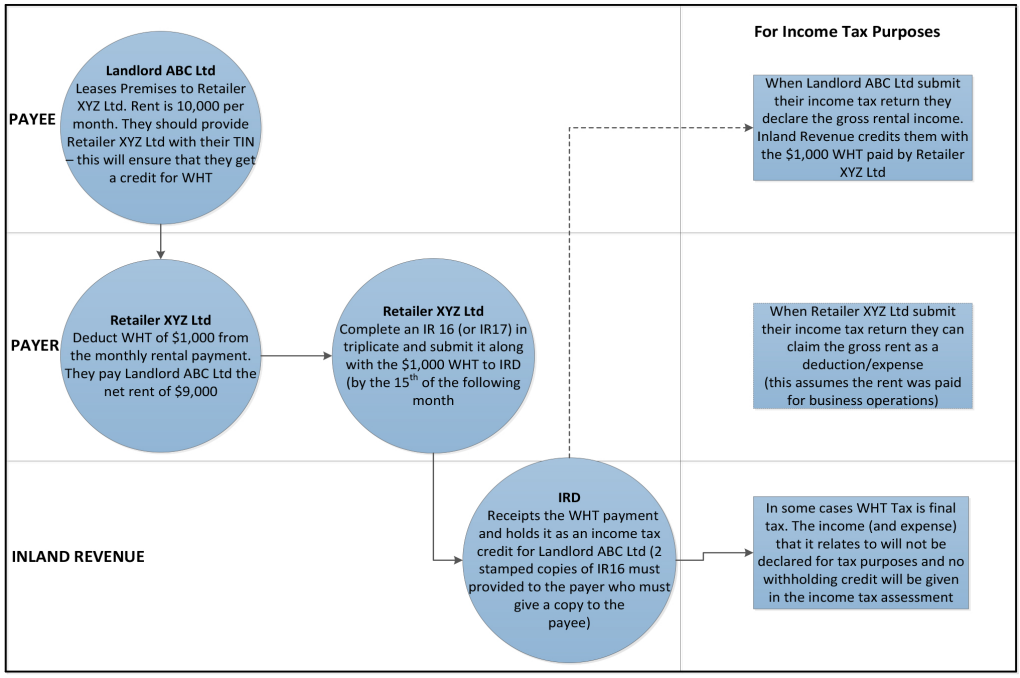
## APPENDIX 1

### The WHT Payment and Assessment Process




***Note:*** *Triplicate means the original Withholding tax payment summary form given to IRD and 2 copies, scanned or photocopied. One copy is given to the landlord and one copy is kept by the tenant.*

## APPENDIX 2

### Conditions for WHT deducted to be final tax

For the withholding taxes deducted to be a final tax, various criteria (as stipulated in paragraph 15) have to be met. These include:

| Person | Resident landlord | Non-Resident landlord |
|---|---|---|
| Individual | Rental income only and rental income and Business income - The correct amount of RWT has been deducted; and - RWT that has been deducted has been remitted to IRD; Income tax payable on business income | Rental income only and rental income and Business income: - The correct amount of RWT has been deducted; and - RWT that has been deducted has been remitted to IRD; Income tax payable on business income |
| Non-individual | Never | Rental income only: - The correct amount of RWT has been deducted; and - RWT that has been deducted has been remitted to IRD; |

## APPENDIX 3

## LEGISLATION

The applicable sections of the Income Tax Act Cap 123 to the taxing of rental income are set out below:

| Section of the Act | Description |
|---|---|
| 2 | **Definitions**:<br>***"resident in Solomon Islands"***<br>(a) in an individual, means that such individual resides, except for such temporary absences as to the Commissioner may seem reasonable, in Solomon Islands; and an individual shall be deemed to reside in Solomon Islands if he:<br>(i) was present in Solomon Islands for a period or periods exceeding in the aggregate six months in such year; or<br>(ii) satisfies the Commissioner that he intends to reside in Solomon Islands for a period or periods exceeding in the aggregate six months in such year; or<br>(iii) was present in Solomon Islands or satisfies the Commissioner that he will be present in Solomon Islands in such year in fulfillment of a contract of employment exercised or mainly exercised in Solomon Islands, which is specified to be of not less than six months' duration;<br>Provided that the Commissioner may, if he is satisfied taking into account the nature of the contract of employment and the method of payment for such services, treat such individual as nonresident, notwithstanding that at the relevant time such individual satisfies the requirements of this paragraph;<br>(b) to a body of persons, means a body of persons which is incorporated in Solomon Islands, or, in the case of a body of persons not incorporated in Solomon Islands, is a body of persons which carries on business in Solomon Islands and has either its central management and control in Solomon Islands or its voting power controlled by shareholders who are resident in Solomon Islands:<br>and references in this Act to "resident" or "non-resident" in relation to any person, mean that such person is resident in Solomon Islands or is not resident in Solomon Islands, as the case may be; |
| 2 | **Definitions:**<br>***"body of persons"*** means any company, association, fellowship or society, whether incorporated or unincorporated, or any trustees, other than the trustees for an incapacitated person, but, for the purposes of sections 3 and 33, does not include a partnership; |
| 20(2B) | If a person is required to deduct tax from a payment under a tax deduction provision and, in the absence of this subsection, the person would be allowed a deduction under the Act for the payment, the person shall not be allowed the deduction until the correct tax required to be deducted has been paid to the Commissioner. |

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| 37(1) | To the extent that the income specified in subsection (2) is not exempt from tax, every person resident in Solomon Islands who makes a gross payment to any person or group of persons resident in Solomon Islands shall deduct there from tax at the appropriate withholding rate specified in the Seventh Schedule:<br>Provided that where the recipient of income specified in subsection (1) is an individual in secondary employment, the tax shall be deducted from such income paid to such individual at the rate prescribed in the Tax Deduction Rules, 1989[9].<br>Provided further that, where the Commissioner agrees with such person to accept an alternative arrangement for payment of the tax which may fall due under this section, he may declare such person exempt in part or in whole from the provisions of this section. |
| 37(2)(d) | (2) For the purpose of subsection (1), income paid to a resident person as a gross payment and subject to resident withholding tax consists of:<br>(d) income from lease of property; |
| 37(7) | ***Definitions:***<br>"***gross payment***" means in relation to an amount, the total amount without deduction whatsoever;<br>"***Income from lease of property***" means gross payment for a sub- lease and any licence, concessions, permission, easement or other rights granted to any person to use or over any land, and an agreement for such a concession; whether or not such a lease of property is effected by an oral or written agreement, and in the case of a written agreement, whether or not such document is required to be registered under the Land and Titles Act. |
| 38(2) | ***Definitions***:<br>"***resident***" in relation to any person, means a person who is a resident within the meaning of section 2 and also includes any person who is engaged in trade or business in Solomon Islands through a permanent establishment situated therein in relation to any income paid to such person or any payment made by such person which is an allowable deduction under this Act.<br>"***permanent establishment***" means a branch, management or other fixed place of business but shall not include an agency unless the agent has and habitually exercises a general authority to negotiate and conclude contracts on behalf of such person or has a stock of merchandise from which he regularly fills orders on behalf of such person. |
| 38(3)(j) | For the purposes of this section non-resident income includes any income that consists of:<br>(j) income from lease of property |
| 38A | Tax required to be deducted by a person under a tax deduction provision shall be paid to the Commissioner within fifteen days after the end of the month in which the person was required to deduct the tax. |
| 38B | (1) If a person:<br>(a) fails to deduct tax as required under a tax deduction provision; or<br>(b) having deducted tax fails to pay the tax to the Commissioner as required under section 38A,<br>the person shall be personally liable to pay to the Commissioner the amount of tax, and any penalty and additional tax due in respect of the failure.<br>(2) A person liable for an amount of tax under subsection (1) as a result of failing to deduct the tax shall be entitled to recover the tax (but not any penalty or additional tax due in respect of the failure) from the recipient of the payment. |
| 38C | (1) If a person fails to deduct tax as required under a tax deduction provision, the Commissioner may recover the tax from the recipient of the payment provided the total amount recovered does not exceed the tax that should have been deducted.<br>(2) Notwithstanding the recovery of any tax under subsection (1), the person who failed to deduct the tax shall continue to be liable for:<br>(a) any other legal action in relation to the failure;<br>(b) the imposition of any penalty or additional tax in respect of the failure; and<br>(c) the disallowing of a deduction for the expenditure to which the failure relates under section 20(2A)[10]. |

*9 These 1981 Tax Deduction Rules should have repealed in 2005 with the introduction of the 2005 Tax Deduction Rules. This oversight has been corrected by section 102 of the Legislation, Repeal and Amendment Act 2023*

*10 This reference to section 20(2A) appears to be a drafting oversight as a new section 20(2A) was inserted by the Income Tax (Amendment) Act 2014 and the then existing section 20(2A) was renumbered as section 20(2B).*

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| 38D & 38G | 38D A person deducting tax under a tax deduction provision shall, at the time of deducting the tax, furnish the recipient of the payment with written evidence that tax has been deducted from the payment.<br>38G (1) A person deducting tax from a payment under a tax deduction provision shall furnish the recipient of the payment from which tax has been deducted with an annual tax deduction certificate in the form and manner prescribed.<br>(2) A person required to furnish a return of income for a year shall attach to the return the annual tax deduction certificate for any income in respect of which the deducted tax is not a final tax on the income. |
| 38H | A person deducting tax from a payment under a tax deduction provision shall furnish to the Commissioner a monthly summary in the form and manner prescribed. |
| 40A | 40A. (1) Subject to subsection (2), this section applies to tax deducted under the following sections provided the correct amount has been deducted and paid to the Commissioner -<br>(a) section 36 if the dividend is paid to -<br>(i) a person who is not resident in Solomon Islands;<br>(ii) resident body of persons other than a company; or<br>(iii) resident individual person;<br>(b) section 36A;<br>(c) section 36B, if the interest is paid by a financial institution and is derived by a resident individual;<br>(d) section 37, if the payment is -<br>(i) made to a resident body of persons other than a company;<br>(ii) made to a resident individual when the total income of the individual including the payments covered by section 37 for the year is less than $10,000; or<br>(iii) income is covered by section 37(2)(d) and is derived by a resident individual; or<br>(e) section 38. |
| Section 42 of the Tax Administration Act TAA (formerly section 71(3) of the Act) | (1) This section applies if a taxpayer fails to file a return in respect of tax payable.<br>(2) If the Commissioner considers it necessary or expedient, the Commissioner may determine the amount of the tax payable and assess the person accordingly.<br>(3) A default assessment by the Commissioner under subsection (2) does not affect any other liability incurred by the taxpayer under a tax law. |
| Section 24 of the TAA (formerly Section 85 of the Act) | Section 24 so far as is relevant reads:<br>(1) A taxpayer representative is any of the following:<br>(b) in the case of a company, the managing director, the chief executive officer or any director of the company;<br>(c) in the case of a partnership, a partner in the partnership;<br>(d) in the case of a trust, a trustee of the trust;<br>(2) The Commissioner may, by notice in writing to an individual, declare that person to be the representative of a taxpayer (including a taxpayer referred to in subsection (1)(a) to (i)) for the purposes of this section). |

**PUBLIC RULING**
Section 149

**PUBLIC RULING 2025/1**

**INCOME TAX: WHEN ARE LEAVE PASSAGE BENEFITS AND INSURANCE PREMIUM BENEFITS PROVIDED BY AN EMPLOYER ASSESSABLE TO AN EMPLOYEE**

1 This publication is a Public Ruling made under section 149 of the Tax Administration Act 2022 and applies as an interpretation of provisions in the Income Tax Act (Cap. 123).

**TAXPAYER PROTECTION**

2 This Ruling provides you with the following level of protection:

This Ruling sets out how a tax law applies in relation to a type of person or a type of arrangement.

You can rely on this Ruling (excluding commentary and appendices) to provide you with protection from interest and penalties in the way explained below. If a statement in this Ruling turns out to be incorrect because of a Court decision and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the Ruling in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

**TAXATION LAWS**

3 All legislative references to "the Act" are to the Income Tax Act (Cap. 123).

**PERSONS AND ARRANGEMENTS TO WHICH THIS RULING APPLIES**

4 This Ruling applies to employees who are provided with certain benefits-in-kind (also called non-cash benefits) by their employer. Employers can provide their employees with a range of benefits, which benefits are being offered because of the employment relationship.

5 The Ruling provides guidance as to whether:

(a) travel known as leave passage provided to local or expatriate employees and dependents of employees by an employer is to be included as a benefit-in-kind in an employee's income from employment;

(b) cash or cash deposits paid by an employer to an employee for the purpose of their and their dependents leave passage based on a reasonable estimate of the cost of the travel, instead of prearranged tickets or reimbursement is to be included in the employee's income from employment; and

(c) the payment by an employer of life insurance and/or medical insurance premiums on behalf of an employee and their dependents is a benefit-in-kind.

**HOW THE TAXATION LAWS APPLY TO THIS ARRANGEMENT**

6 Section 5 (1) of the Income Tax Act (the Act) provides that for the purposes of section 3(1)(a)(ii) of the Act and subject to subsection (2), gains or profits from employment means any amount, whether of a revenue or capital nature, arising from employment, including - (b) the value of any benefit-in-kind, whether convertible to money or not;

7 Section 5 explains the meaning of gains and profits from employment. In broad terms, any amount arising from employment is treated as employment income.

8 Paragraph 5(1)(b) expressly provides that the value of any benefit-in-kind, commonly known as non-cash benefits, is included in employment income, whether it is convertible to money or not This overrides the general principle that a benefit that is not convertible to cash is not income.

9 As set out in subsection 5(2) of the Act, the following benefits are not included in gains or profits from employment:

(a) the cost of passages paid by an employer for passage of an employee within Solomon Islands or between Solomon Islands and any place outside Solomon Islands;

(b) the cost of any medical services paid by the employer; or

(c) the amount paid by an employer as a contribution to any approved pension fund or the Solomon Islands National Provident Fund to the extent that such amount does not exceed fifteen per centum of the employee's employment income for the year in which the contribution is made.

10 This Ruling covers the first two exceptions.

**Leave Passage**

11 Paragraph 5(2)(a) of the Act provides that the cost of passages paid by an employer for passage of an employee within Solomon Islands or between Solomon Islands and any place outside Solomon Islands is an excluded benefit-in-kind and therefore not assessable to the employee as gains or profits from employment. The excluded benefit-in kind for the cost of passage for employees is limited to one trip per year in accordance with the Labour Act rules "the Holidays, Sick Leave and Passages Rules" (see paragraph 10, page 6 in the Commentary below).

12 The Act does not deal with the treatment of leave passage provided by an employer for dependents of an employee. As an administrative concession, the Commissioner considers leave passage travel provided by an employer for dependents of local employees, is also a benefit-in-kind that falls within the exception in section 5(2)(a) of the Act. The concession for an employee's dependents is in accordance with the Labour Act rules titled "the Holidays, Sick Leave and Passages Rules".

13 While the Holidays, Sick Leave and Passages Rules do not apply to expatriate workers, the Commissioner considers this administrative concession for local employee's dependents should also apply to dependents of expatriate employees.

14 The concession for dependents applies provided that the cost of travel is for only one trip a year to their home village or country at the economy rate of travel by boat or air. If an employer pays for more than one trip for dependents in a year and/or for business class / first class, then the number of trips and/or difference in travel class is a taxable benefit to the local or expatriate employee.

15 The Commissioner understands that, given the unpredictable nature of travel

in Solomon Islands where transport options are often informal and depend on weather and infrastructure conditions, employers pay their local employees by way of cash/deposit into a bank account or a cash allowance for the purpose of leave passage based on a reasonable estimate of the cost of the travel, instead of prearranged tickets or reimbursement.

Accordingly, the Commissioner will treat, as an administrative concession, the cash or cash allowance paid in such circumstances is included in the exception in paragraph 5(2)(a) and it is an amount that is not included in gains or profits from employment.

16 This concession does not apply to expatriate employees and their dependents if they receive cash or a cash allowance. In that case, the allowance is taxable under section 5(1)(c) of the Act as a travel allowance not expended wholly and exclusively in the performance of the employee's duties of employment as formal travel providers are available.

**Insurance Premiums**

17 Prior to the year 2000, former section 31 of the Act provided that an individual was entitled to an additional personal exemption of the amount of the payment of a premium on a policy of medical insurance that provides for the cost or part of the cost of medical treatment of himself, his wife or any child, exceeding one hundred dollars unless the whole or part of such expenditure was paid by the employer in which case the allowance was reduced by the amount of the expenditure paid by the employer.

18 However, when the cost of medical services was re-introduced in 2005 as an exclusion from gains or profits from employment there was no reference to medical insurance premiums. The Commissioner considers that, as this part of the definition in section 31 was not included in the benefit-in-kind exclusion of medical services, the payment by an employer of life insurance and/or medical insurance premiums on behalf of an employee and/or their dependents is not an excluded benefit-in-kind under paragraph (b) of section 5(2) of the Act.

19 The payment of a premium on a policy of medical insurance is a benefit-in-kind but does not fall within the exception to the general rule that is provided under 5(2)(b) of the Act. This is because there is no cost of any medical services, formerly called medical treatment, paid by the employer. Whilst there is no definition of "medical services" in the Act, the ordinary meaning of the term does not include medical insurance premiums as the payment of a premium is made regardless of whether any medical costs have been or will be incurred by the employee. The total premium is apportioned according to the number of employees covered by the policy.

**DATE OF EFFECT**

20 This Ruling applies to years of income commencing both before and after its date

of issue. This 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.

Dated this eighteenth-day of February 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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**COMMENTARY**

1 This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in this Ruling.

2 Legislative references are to the Income Tax Act (Cap. 123) unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

3 This commentary provides guidance as to whether:

(a) Travel, known as leave passage, provided to dependents of expatriate employees by an employer is to be included as a benefit in kind in an employee's income from employment.

(b) an arrangement, where an employer pays a cash amount or cash allowance to a local employee to cover the cost of leave passage, rather than paying for the actual cost of the leave passage, is included as leave passage and not a benefit to be included as a benefit-in-kind.

(c) the payment by an employer of life insurance and/or medical insurance premiums on behalf of an employee and their dependents is a benefit-in-kind.

**Summary**

4 Section 5 (1) of the Income Tax Act (Cap.123) provides that for the purposes of section 3(1)(a)(ii) of the Act and subject to subsection (2), gains or profits from employment means any amount, whether of a revenue or capital nature, arising from employment, including - (b) the value of any benefit-in-kind, whether convertible to money or not;

5 The benefit-in-kind provision is intended to ensure that employers do not substitute the payment of an amount of an employee's income for non-cash benefits and thus avoid paying PAYE withholding tax. If a value can be determined, that is the value for the purposes of the provision. If a value cannot be determined it is the market value of the benefit-in-kind, if converted to money, disregarding anything that would prevent or restrict conversion of the benefit to money. For example, a non-transferable airline ticket that is not able to be converted to cash.

6 As set out in subsection 5(2) of the Act, the following benefits are not included

in gains and profits from employment:

(a) the cost of passages paid by an employer for passage of an employee within Solomon Islands or between Solomon Islands and any place outside Solomon Islands;

(b) the cost of any medical services paid by the employer; or

(c) the amount paid by an employer as a contribution to any approved pension fund or the Solomon Islands National Provident Fund to the extent that such amount does not exceed fifteen per centum of the employee's employment income for the year in which the contribution is made.

7 The Ruling covers the first two exceptions.

**Dependent Travel**

8 Paragraph 5(2)(a) provides that it is the cost of passages paid by an employer for passage of an employee that is an exception and not included in gains and profits from employment. The excluded benefit-in kind for the cost of passage for employees is limited to one trip per year in accordance with the Labour Act rules "the Holidays, Sick Leave and Passages Rules" (see paragraph 10 below).

9 Section 5(2)(a) of the Act does not deal with the treatment of leave passage provided by an employer for dependents of an employee. However, under section 80 of the Labour Act (Cap. 73), the Minister of Commerce, Industry, Labour and Immigration (the Minister) may make Rules that provide for employees to be entitled to holidays and for the payment of leave passages to enable workers to return from their place of employment to their home island during such holidays or at the termination of their employment.

10 The Minister has made Rule 5 titled "the Holiday, Sick leave and Passage Rules" which requires the employer to pay for such costs. Under Rule 5(1), a worker taking a paid holiday is entitled once every year to be paid by his employer the cost of return journeys made between the place of employment and the worker's home. "Home" is defined as the village in Solomon Islands regarded in custom as the place of origin of the worker. Rule 5(2) provides that the Rules shall not apply to migrant (expatriate) workers but shall apply to all other workers employed in an undertaking.

11 Under the Rules, the employer must also provide for the cost of return journeys for up to four (4) dependents. The Commissioner considers that "passage of an employee" in section 5(2)(a) of the Act is to be taken to include up to 4 of the employee's dependents to be consistent with Rule 5 of the Holiday, Sick leave and Passage Rules.

12 The Commissioner, as an administrative concession, will not tax local or expatriate employees on the value of any leave passage amount paid by an employer to the employee for an employee's dependents. However, the concession is limited to one return trip per year to their home village or country at the economy rate

of travel by boat or air. If an employer pays for more than one cost of travel for dependents in a year and/or for business class for the dependent, then the additional number of trips and/or difference in travel class is a taxable benefit to the employee.

13 The Commissioner understands that, given the unpredictable nature of travel in Solomon Islands where transport options are often informal and depend on weather and infrastructure conditions, employers pay their local employees by way of cash or cash allowance for the purpose of leave passage based on a reasonable estimate of the cost of the travel, instead of prearranged tickets or reimbursement. In these cases, the Commissioner will, as an administrative concession, treat the cash allowance as an exception as provided in 5(2)(b) and excluded as a taxable benefit-in-kind to the employee.

14 This concession does not apply to expatriate employees and their dependents if they receive a cash allowance. In that case, the allowance is taxable under section 5(1)(c) of the Act as formal travel providers are available (and it is a travel allowance not expended wholly and exclusively in the performance of the employee's duties of employment).

**EXAMPLE**

**Travel**

15 An expatriate CEO's contract provides that she is entitled to payment by the company of 2 return trips per year travelling first class back to her country of origin. The employer pays also for 2 return trips per year travelling business class for the employee's 4 legal dependents including her partner/husband.

16 The employer should deduct PAYE at the employee's marginal tax rate on the value of the difference between the first-class fare and the business rate for the expatriate employee's first trip and deduct PAYE on the entire value of the expatriate employee's second return trip. In addition, the employee is taxed on the second return trip of each of the dependents as well as the difference in value of the business and economy airfares of the dependent.

17 In this Ruling, dependent means the accompanying wife or husband or partner of the employee and up to 4 accompanying legal children under the age of 18 years.

**Insurance Premiums**

18 The Commissioner considers that the payment by an employer of life insurance and/or medical insurance premiums on behalf of an employee and their dependents is a benefit-in-kind under paragraph (b) of section 5(1) of the Act. The benefit is not an exception to the general rule that is provided under 5(2)(b) of the Act as whilst there is no definition of "medical services" in the Act, the ordinary meaning of the term does not include medical insurance premiums as there is no cost of any medical services paid by the employer. The payment of the premium is made regardless of whether any medical services/costs have been or

will be incurred by the employee. The total premium is apportioned according to the number of employees covered by the policy.

**EXAMPLE**

**Insurance Premiums**

19 A company takes out a general medical insurance policy covering its employees including its expatriate employees. The company pays for the premium of the insurance which provides protection from the expense of medical expenses that may be incurred by the employee in the event of accident or illness. The company also takes out a life insurance policy for its key employees.

20 In both cases the premium paid is not an exception to the general rule provided under 5(2)(b) as there is no cost of any medical services paid by the employer. The payment of the premium is made regardless of whether any medical costs have been or will be incurred by the employee. Each employee is subject to PAYE on the total premium paid by the employer divided by the number of employees covered by the policy. For example, if there are 50 employees covered by the policy and the premium is $50,000 then each employee has PAYE deducted at their marginal tax rate on $1,000.

**APPENDIX 1**

**LEGISLATION**

Section 5(1) of the Income Tax Act (the Act) provides that for the purposes of section 3(1)(a)(ii) of the Act and subject to subsection (2), gains or profits from employment means any amount, whether of a revenue or capital nature, arising from employment, including -

(b) the value of any benefit-in-kind, whether convertible to money or not Subsection 5(2) of the Act, provides that the following benefits are not included in gains or profits from employment:

(a) the cost of passages paid by an employer for passage of an employee within Solomon Islands or between Solomon Islands and any place outside Solomon Islands;

(b) the cost of any medical services paid by the employer; or

(c) the amount paid by an employer as a contribution to any approved pension fund or the Solomon Islands National Provident Fund to the extent that such amount does not exceed fifteen per centum of the employee's employment income for the year in which the contribution is made.

Dated this first-day of April 2025.

**JOSEPH DOKEKANA**
COMMISSIONER OF INLAND REVENUE

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