

# ***MT 2008/D1 - Penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard***

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This document has been finalised by MT 2008/1.

! There is a Compendium for this document: **MT 2008/1EC** .



# MT 2008/D1

## Date of effect

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5. It is proposed that when the final Ruling is issued, it will apply both before and after its date of issue. However, the Ruling will not apply to entities to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

## Previous Ruling

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6. This Ruling updates Taxation Ruling TR 94/4. Accordingly, TR 94/4 is withdrawn from the date of issue of this Ruling.

## Background

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### Legislative framework

7. The administrative penalty regime, which includes Division 284 applies from 1 July 2000, in relation to:

- income tax matters for the 2000-01 and later income years;
- for fringe benefits tax (FBT) matters for the year commencing 1 April 2001 and later years; and
- matters relating to other taxes for the year commencing 1 July 2000 and later years.

8. The regime sets out uniform administrative penalties that apply to entities that fail to satisfy certain obligations under different taxation laws.

9. The administrative penalty provisions consolidate and standardise the different penalty regimes that previously existed. In addition, the provisions apply in respect of various taxes and collection systems including income tax, FBT, goods and services tax (GST) and pay as you go withholding and instalments.

10. Division 284 imposes penalties where an entity:

- makes a statement which is false or misleading in a material particular – subsection 284-75(1);
- takes a position under an income tax law that is not reasonably arguable – subsection 284-75(2) (Draft Miscellaneous Taxation Ruling 2008/D2 explains the concept of reasonably arguable position);
- fails to provide a return, notice or other document to the Commissioner that is necessary to determine a tax-related liability, and the Commissioner determines the liability without the document – subsection 284-75(3);

- disregards a private ruling;<sup>1</sup> or
  - enters into a scheme to get a scheme benefit – section 284-145.
11. Broadly, subsection 284-75(1) imposes a penalty where:
- an entity or its agent makes a statement to the Commissioner or to an entity that is exercising powers or performing functions under a taxation law;<sup>2</sup> and
  - the statement is false or misleading in a material particular whether because of things in it or omitted from it; and
  - there is a shortfall amount as a result of the statement.
12. However, the exception in subsection 284-215(2) means that there is no shortfall amount as a result of a false or misleading statement to the extent reasonable care was taken in making the statement.
13. An entity's agent, in this context, means someone who is authorised to represent the entity in making a statement to the Commissioner.
14. A statement may be made or given in writing, orally or in any other way, including electronically. A statement may be made in correspondence, in a response to requests for information, in a notice of objection, in a request for an amendment to an assessment, in an answer to a questionnaire or in connection with an audit or investigation.
15. In the context of self assessment, where entities determine their own tax liabilities, a statement will include entering an amount or other information at a label or on an application, approved form, business activity statement, instalment activity statement, certificate, declaration, notice, notification, return or other document prepared or given under a taxation law.
16. Entering an amount at a label will generally be a statement of mixed fact and law in so far as it represents that the amount returned was received, expended or withheld and that the amount was the correct amount assessable, deductible or reportable as appropriate.
17. Items 1 and 2 of the table in subsection 284-80(1) list the circumstances relating to a false or misleading statement that give rise to a shortfall amount. Where one of those items applies, the shortfall amount is the amount by which a tax-related liability is less than, or a payment or credit is more than, it would have been if the false or misleading statement had not been made.

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<sup>1</sup> This penalty does not apply in relation to income tax matters for the 2004-05 and later income years, FBT matters for the year beginning on 1 April 2004 and later years, and matters relating to other taxes for the year beginning 1 July 2004 and later years.

<sup>2</sup> Under subsection 2(2) of the TAA an Excise Act (as defined in subsection 4(1) of the *Excise Act 1901*) is not a taxation law for purposes of Subdivision 284-B.

# MT 2008/D1

18. If an entity is liable to an administrative penalty under subsection 284-75(1), then under subsection 298-30(1) the Commissioner must make an assessment of the amount of penalty. This assessment is made in accordance with the formula described in section 284-85 as follows:

- calculate the base penalty amount under subsection 284-90(1); and
- increase (section 284-220) or decrease (section 284-225) the base penalty amount if certain conditions are satisfied.

19. The base penalty amount under subsection 284-90(1) for a penalty imposed under subsection 284-75(1) reflects the level of care taken by the entity or agent in making a false or misleading statement. Basically, the more culpable the behaviour leading to the shortfall amount, the higher the level of penalty.

20. Where the shortfall amount results from a failure to take reasonable care, the base penalty under item 3 of the table in subsection 284-90(1) is 25% of the shortfall amount. Where recklessness as to the operation of a taxation law results in the shortfall amount, the base penalty amount is 50% of the shortfall amount under item 2 of the table in subsection 284-90(1). A base penalty amount of 75% of the shortfall amount applies under item 1 of the table in subsection 284-90(1) if the shortfall amount results from intentional disregard of a taxation law.

21. The Commissioner is required under section 298-10 to provide an entity with written notice of any liability for an administrative penalty and the reasons why the entity is liable to pay the penalty. However, the Commissioner is not required to provide reasons where a decision is made to remit all of the penalty.

22. Under subsection 298-30(2) an entity that is dissatisfied with an assessment of penalty may object to it in the manner set out in Part IVC of the TAA.



# MT 2008/D1

27. The reasonable care test requires an entity to take the same care in fulfilling their tax obligations that could be expected of a reasonable ordinary person in their shoes. This means that even though the standard of care is measured objectively, it takes into account subjective factors. The subjective aspect of the test is addressed in the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000 where it states at paragraph 1.69:

Reasonable care requires a taxpayer to make a reasonable attempt to comply with the provisions of the ITAA and regulations. The effort required is one commensurate with all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.<sup>5</sup>

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

## ***Parallels with the law of negligence***

### *Factors taken into account in determining negligence*

29. Although the concept of 'reasonable care' is not defined, the expression has a long history of usage in the context of tort law. A failure to exercise reasonable care in relation to conduct causing harm is central to proving negligence.

30. In proving negligence under the common law, the benchmark standard of care demanded of a person subject to a duty of care depends on what a reasonable person of ordinary prudence would have done or would not have done in response to a foreseeable risk of injury. This involves the application of an objective test generally without regard to the personal characteristics or idiosyncrasies of the person whose conduct is in question.<sup>6</sup> To this extent there is a difference between the test for proving negligence and determining whether reasonable care is shown in complying with tax obligations which does have regard to an entity's particular circumstances including their knowledge, education, experience and skill.

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<sup>5</sup> Refer to the proposals made in the information paper at paragraphs 2.7 to 2.12 (discussed in paragraph 24 of this Ruling) which were given effect to by the *Taxation Laws Amendment (Self Assessment) Act 1992*.

<sup>6</sup> A notable exception is someone with special knowledge or skill over and above what would ordinarily be expected of a reasonable person. Such a person must meet the standard of behaviour expected of a reasonable person with that special knowledge or skill.





41. This principle was emphasised in *Reeders v. FC of T* [2001] AATA 933; 2001 ATC 2334; (2001) 48 ATR 1170 where it was decided that the entity had demonstrated reasonable care by consulting a tax agent in relation to a claim made to deduct self education expenses. A penalty had been imposed under former section 226G of ITAA 1936 in respect of the agent's presumed lack of reasonable care because of the absence of evidence to show that reasonable care had been taken. The AAT found that the decision making process was flawed because it had failed to identify and consider the evidence that suggested a want of care. At paragraph 16 Tribunal member McCabe stated:

Section 226G should not be approached on the basis that a penalty is imposed in the event of a shortfall, with the possibility of an exemption if the taxpayer is able to satisfy the decision maker that the taxpayer or his or her tax agent took reasonable care. A penalty under s226G is not triggered until the decision maker is satisfied that both limbs of the section are satisfied. Since the decision-maker in this case did not appear to consider whether the shortfall was attributable to a want of care on the part of the taxpayer or his ... agent, the penalty should not have been imposed.

### ***Importance of individual circumstances***

42. Whether or not a shortfall amount results from a failure by an entity 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 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 done to avoid the risk of making a statement that is false or misleading underpins the imposition of penalty for failing to take reasonable care.

43. The appropriate standard of care required in making a statement is not immutable but takes account of the particular characteristics of the person concerned. Because there is no 'one size fits all' standard, a decision to impose penalty necessarily takes account of:

- personal circumstances (such as age, health, and background);
- level of knowledge, education, experience and skill; and
- understanding of the tax laws.

# MT 2008/D1

44. Another consideration that influences the standard of care that is reasonable in the circumstances is the class of entity concerned. For example, as the Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000 notes, a salary and wage earner is likely to show reasonable care by diligently following the instructions in *TaxPack* as their obligations would be relatively straightforward. In contrast, an entity that conducts a business and has more onerous tax obligations arising from more complex transactions would be expected to implement appropriate record keeping systems and other procedures to ensure they comply with their tax obligations.

## *Personal circumstances*

45. 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.

### *Example 1 – circumstance of ill health – reasonable care taken*

46. *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.*

47. *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.*

### *Example 2 – personal circumstances do not support reasonable care*

48. *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 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.*





























