

FACT SHEET | PUKA MEKA

Shortfall penalty for not taking reasonable care

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IS 26/04 FS 1

This fact sheet accompanies interpretation statement [IS 26/04: Shortfall penalty for not taking reasonable care](#), which explains the meaning of “reasonable care” in relation to the shortfall penalty for not taking reasonable care in s 141A of the Tax Administration Act 1994.

All legislative references are to the Tax Administration Act 1994.

Key terms | Kīanga tau tāpua

Tax position	A position or approach regarding tax under a tax law.
Tax shortfall	The difference between the tax effect of the taxpayer’s tax position for the return period and the correct tax position for that period.

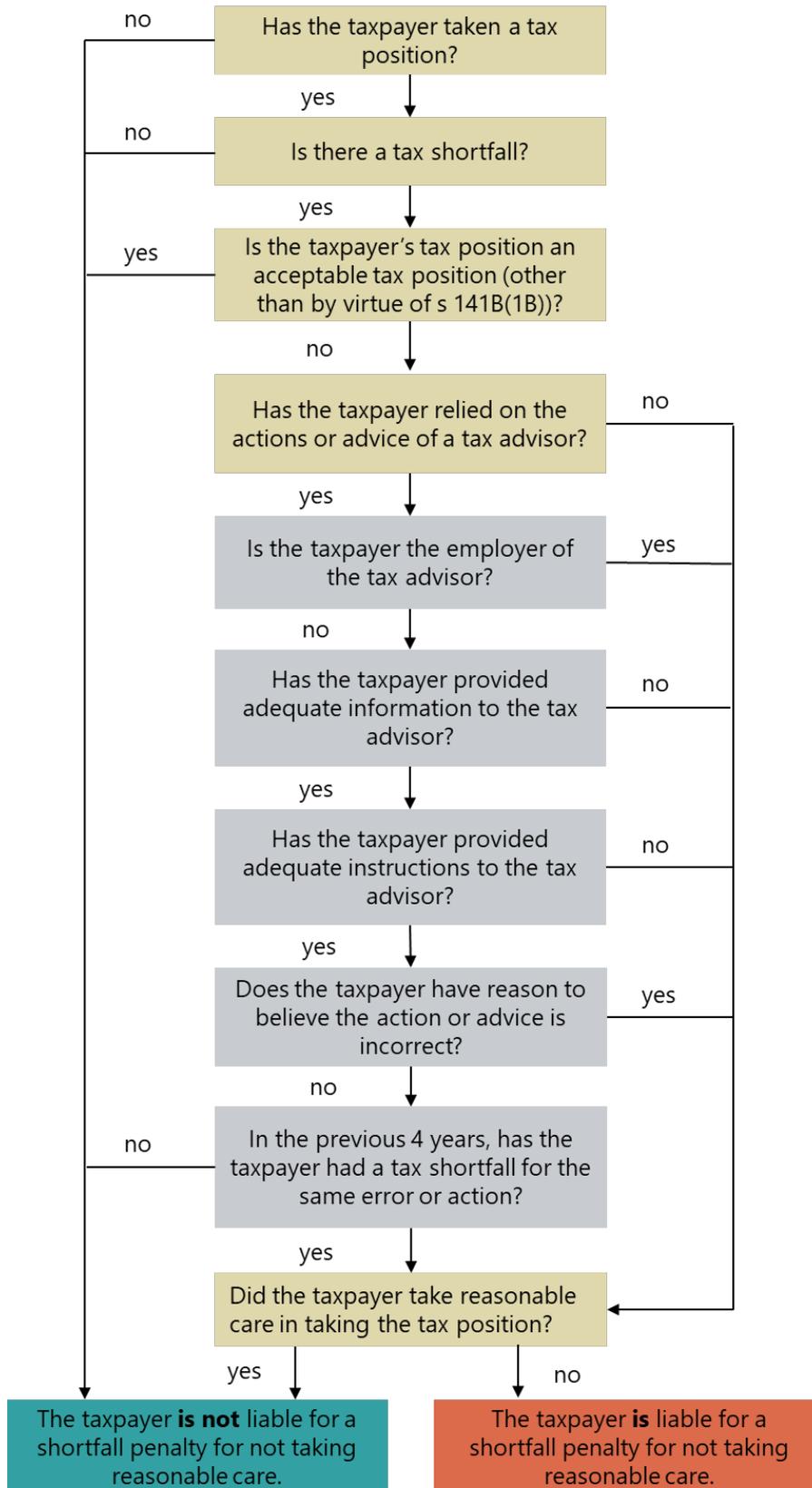
Shortfall penalty for not taking reasonable care

Overview

1. A shortfall penalty for not taking reasonable care applies only if:
 - the taxpayer takes a tax position;
 - a tax shortfall arises from the tax position; and
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- the taxpayer did not take reasonable care in taking the tax position.
2. The penalty applies to tax positions taken in relation to most tax types, including GST and income tax. Income tax includes withholding-type taxes treated as income tax, eg PAYE, FBT, and resident withholding tax.
 3. The penalty is 20% of the tax shortfall. The amount of the penalty may be capped at \$50,000 if certain requirements are met and may be reduced in certain situations. The \$50,000 cap applies after the amount of the penalty is determined under s 141A and the other reduction provisions are applied.
 4. [IS 26/03: Shortfall penalties – requirement for a “tax position” and a “tax shortfall”](#) explains the requirements for a “tax position” and a “tax shortfall”.
 5. This interpretation statement explains the meaning of “reasonable care” in s 141A.
 6. [IS 26/09: Shortfall penalties – reductions and other matters](#) explains other matters relevant to the penalty, including the \$50,000 cap on the amount of the penalty, when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, and the assessment, payment and disputing of shortfall penalties.
 7. The following flowchart shows how s 141A applies.

Figure 1 | Hoahoa 1: Flowchart of how s 141A applies



Reasonable care

8. Section 141A imposes a shortfall penalty for not taking reasonable care where:
 - the taxpayer takes a tax position;
 - a tax shortfall arises from the tax position; and
 - the taxpayer did not take reasonable care in taking the tax position.
9. The penalty applies to tax positions taken in relation to most tax types including, amongst others, GST and income tax. Income tax includes withholding-type taxes treated as income tax, eg PAYE, FBT, and resident withholding tax.
10. The penalty is 20% of the tax shortfall. The amount of the penalty may be capped at \$50,000 if certain requirements are met.
11. [IS 26/04](#): **Shortfall penalty for not taking reasonable care** explains the meaning of “reasonable care” as follows:
 - “Reasonable care” means doing what a reasonable person in the particular circumstances would do.
 - Whether a taxpayer takes reasonable care is decided objectively. Whether the taxpayer believed they were being sufficiently careful is irrelevant to this decision.
 - Taking reasonable care involves considering whether a reasonable person in the particular circumstances would have seen the risk of a tax shortfall and the actions they would have taken to prevent it. It includes taking sufficient steps to determine the correctness of a tax position, keeping adequate tax records, and generally making a reasonable attempt to comply with the tax laws. The level of care required may vary depending on factors such as the knowledge and experience of the taxpayer.
 - When deciding whether a reasonable person in the particular circumstances would have seen the risk of a tax shortfall, the Commissioner will consider the size and materiality of the tax shortfall compared with the taxpayer’s overall tax position.
 - Even though a taxpayer who makes a mistake in calculating or recording numbers in a return does not take an “unacceptable tax position” for the purposes of the shortfall penalty for taking an unacceptable tax position, they may still be liable for a shortfall penalty for not taking reasonable care.

- A taxpayer who relies on the advice of a “tax advisor”, or a “tax agent”, to whom they have provided all relevant information, is treated as having taken reasonable care except where the taxpayer:
 - is the employer of the tax advisor;
 - does not adequately inform or instruct the tax advisor about their tax position;
 - has reason to believe that the action or advice is incorrect; or
 - has, in the previous 4 years, had a tax shortfall for the same error or action and has failed to take reasonable care to stop it happening again.
- A taxpayer who takes an “acceptable tax position” is also treated as having taken reasonable care.

About this document | Mō tēnei tuhinga

Some of the Tax Counsel Office’s longer or more complex items are accompanied by a fact sheet that summarises and explains an item’s main points. While it summarises the Commissioner’s considered views, a fact sheet should be read alongside the full item to completely understand the guidance. Fact sheets are not binding on the Commissioner. See further [Status of Commissioner’s advice](#) (Commissioner’s statement, Inland Revenue, December 2012).