

# Shortfall penalty for not taking reasonable care

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IS 26/04

This interpretation statement 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.

## REPLACES | WHAKAKAPIA

- [IS0053](#): Shortfall penalty for not taking reasonable care (October 2005) *Tax Information Bulletin* Vol 17, No 9 (November 2005)

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## Key terms | Kīanga tau tāpua

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

## Introduction | Whakataki

- 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.
- 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.
- The penalty is 20% of the tax shortfall. The amount of the penalty may be capped at \$50,000 if certain requirements are met.<sup>1</sup>
- [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”.

<sup>1</sup> Section 141JAA. See IS 26/09: Shortfall penalties – reductions and other matters.

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 cap of \$50,000 on the amount of the penalty if certain requirements are met, 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 flowchart at Figure 1 | Hoahoa 1: Flowchart of how s 141A applies.

## Summary | Whakarāpopoto

8. In summary, this interpretation statement 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.

## Legislation

### 141A Not taking reasonable care

- (1) A taxpayer is liable to pay a shortfall penalty if the taxpayer does not take reasonable care in taking a taxpayer’s tax position (referred to as not taking reasonable care) and the taking of that tax position by that taxpayer results in a tax shortfall.
- (2) The penalty payable for not taking reasonable care is 20% of the resulting tax shortfall.
- (2B) A taxpayer who, in taking a tax position, relies on an action or advice of a tax advisor engaged by the taxpayer, or by a company in the same group of companies as the taxpayer, takes reasonable care in relying on the action or advice except if the taxpayer—
  - (a) is the employer of the tax advisor:
  - (b) does not provide to the tax advisor adequate information relating to the tax position:
  - (c) does not provide to the tax advisor adequate instructions relating to the tax position:
  - (d) has reason to believe that the action or advice is incorrect:
  - (e) has previously, for a period ending less than 4 years before the beginning of the period to which the tax position relates, had a tax shortfall for the same type of tax arising from a corresponding tax position and does not take reasonable care to avoid the further tax shortfall.
- (3) A taxpayer who takes an acceptable tax position is also a taxpayer who has taken reasonable care in taking the taxpayer’s tax position.
- (4) Subsection (3) and section 141B(1B) do not exclude a taxpayer who makes a mistake in the calculation or recording of numbers in a return from being liable for a penalty for not taking reasonable care.

## Analysis | Tātari

9. The Tax Administration Act 1994 does not define “reasonable care”, other than in specifying that a taxpayer who relies on the action or advice of their tax advisor or takes an “acceptable tax position” is treated as having taken reasonable care.<sup>2</sup>
10. The general meaning of taking reasonable care is explained in the first section. The following sections then set out the circumstances in which a taxpayer is treated as taking reasonable care.

### What it generally means to take reasonable care

11. To take reasonable care is to give appropriately serious attention to imposed obligations.

### The test is objective

12. The test is an objective one. In the context of the shortfall penalty for not taking reasonable care, the test 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.<sup>3</sup> It is irrelevant whether the taxpayer believed they were being sufficiently careful. Whether the taxpayer acted intentionally is not a consideration.<sup>4</sup>

### The test involves taking sufficient steps to determine the correctness of a tax position

13. Taking reasonable care 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.<sup>5</sup>
14. The care expected of taxpayers generally is set out in s 15B:<sup>6</sup>

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<sup>2</sup> Section 141A(2B) and (3).

<sup>3</sup> *Hong v CIR* [2018] NZHC 2,539, (2018) 28 NZTC 23-073, upheld on appeal in *Hong v CIR* [2019] NZCA 336, (2019) 29 NZTC 24-015; *Case W4* (2003) 21 NZTC 11,034; *Case Y21* (2008) 23 NZTC 13,227.

<sup>4</sup> *Case W3* (2003) 21 NZTC 11,014 at [113]; *Case W4* at [60]; *Case Y21* at [74]; *TRA 010/18* [2019] NZTRA 6, (2019) 29 NZTC 5,005 at [66].

<sup>5</sup> *Hong v CIR* (HC); s 15B. See also *Case W3* at [113]; *Case W4* at [60]; *Case Y21* at [74], *TRA 03/11* [2013] NZTRA 03, (2013) 26 NZTC 2,002 at [38] (upheld on appeal in *Brown v CIR* [2014] NZHC 1,599, (2014) 26 NZTC 21-089); *TRA 007/15* [2016] NZTRA 09, (2016) 27 NZTC 3-031 at [45]–[46].

<sup>6</sup> *Hong v CIR* (HC) at [24]. See also *Chapman v CIR* (2002) 20 NZTC 17,950 at [40].

### 15B Taxpayer's tax obligations

A taxpayer must do the following:

- (aa) if required under a tax law, make an assessment:
- (a) unless the taxpayer is a non-filing taxpayer, correctly determine the amount of tax payable by the taxpayer under the tax laws:
- (b) deduct or withhold the correct amounts of tax from payments or receipts of the taxpayer when required to do so by the tax laws:
- (c) pay tax on time:
- (d) keep all necessary information (including books and records) and maintain all necessary accounts or balances required under the tax laws:
- (e) disclose to the Commissioner in a timely and useful way all information (including books and records) that the tax laws require the taxpayer to disclose:
- (f) to the extent required by the Inland Revenue Acts, co-operate with the Commissioner in a way that assists the exercise of the Commissioner's powers under the tax laws:
- (g) comply with all the other obligations imposed on the taxpayer by the tax laws.

### **The size and materiality of the tax shortfall will be considered**

15. 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 of the tax shortfall compared with the taxpayer's total tax liability;
  - the size of the error compared with the amount of the taxpayer's assessable income, if the tax shortfall relates to incorrect assessable income; and
  - the size of the error compared with the amount of the taxpayer's deductions if the tax shortfall relates to incorrect deductions.
16. In *Case W4*, Judge Barber said:

[61] ... Materiality must be implicit in the standard of reasonable care so that consideration will be given not only to the nature of the shortfall, but also to its size in relation to the taxpayer. ...
17. The more substantial the tax shortfall is relative to the taxpayer's tax liability, or the more substantial the error is compared with the taxpayer's assessable income or deductions, the more likely it may be that a reasonable person would have seen the risk and taken appropriate action.

18. For example, omitting to return \$10,000 income is substantial when compared with a total assessable income of \$60,000. The relatively large size of the error suggests a reasonable person would have realised \$50,000 assessable income was too low and would result in a tax shortfall, and that they should double-check the amount.
19. On the other hand, omitting to return \$10,000 income is not substantial when compared with a total taxable income of \$50 million. The relatively small size of the error would not necessarily suggest a reasonable person would have realised \$50 million assessable income was too low and would result in a tax shortfall, and that they should double-check the amount.
20. The number of transactions giving rise to the income or deductions may also be relevant. For example, it may be easier to review and check a smaller number of transactions than a large volume. This is, however, subject to the expectation that to take reasonable care with a large volume of transactions, or with a smaller volume of transactions that involve large amounts, the taxpayer would be expected to have suitable systems in place to deal with these transactions.

### **The level of care may vary depending on the circumstances**

21. A taxpayer must make the effort that a reasonable person would make in the circumstances.<sup>7</sup> The actions a reasonable person would have taken to prevent a tax shortfall may vary depending on the circumstances and factors such as:<sup>8</sup>

- the complexity of the particular transaction and the tax law;
- how difficult it would have been to prevent the tax shortfall;
- for a business, the size and nature of the business and its internal controls and record-keeping practices;
- the taxpayer's health; and
- the taxpayer's knowledge and experience of business and tax matters.

22. In *Case W3*, Judge Barber listed the factors to consider:

[113] In terms of the concept of not taking reasonable care, **I accept that the level of care may vary depending upon the type of tax involved and the size and nature of the business under scrutiny. One needs to consider the complexity of the law, the particular transaction, the gravity of the consequence of size of the risk regarding the shortfall, and the difficulty and expense of taking appropriate precautions and, for a business, the size and nature of it and its internal controls and record keeping practices. There may be varying degrees of care required depending on the particular circumstances.** An expert in a particular field is not required to exercise a

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<sup>7</sup> *Case W4* at [61].

<sup>8</sup> *Case W3; Case W4; Case Y21; Brown v CIR; TRA 010/18.*

greater degree of care than an ordinary person unless holding himself (or herself) out to be such. *Stokes v Guest, Keen & Nettlefold (Bolts & Nuts) Ltd* [1968] 1 WLR 1776. An inexperienced person must exercise the care of an ordinary person *Nettleship v Weston* [1971] 2 QB 691 at p 699 per Lord Denning. **It is not whether a person tried to exercise reasonable care but rather whether he or she has in fact done so** *Bailey v Taylor* [1936] NZLR 806 (SC). The burden of proof is always on the taxpayer. [Emphasis added]

23. In *Case Y21*, Judge Barber stated there must be some tolerance of a person suffering ill health at material times:

[80] I agree with the contention for the Commissioner that the disputant has not acted as a reasonable person would have in the same circumstances. **I consider there needs to be quite some tolerance of a person suffering continued ill health at material times** as the disputant did, but the disputant's lack of records is reprehensible. The shortfall penalty for lack of reasonable care must be applied pursuant to s 141A of the Act (as distinct for gross carelessness pursuant to s 141C). [Emphasis added]

24. The level of care required is that appropriate for a reasonable person in the same category of taxpayer, rather than that of the individual taxpayer concerned. In *Case W4*, Judge Barber said:

[61] **The effort required of the taxpayer is commensurate with the reasonable person in the taxpayer's circumstances. What must be expected is the achievement of a standard appropriate to the category of taxpayer, rather than that of the individual taxpayer concerned.** ... This means there may be varying degrees of care required depending on the particular circumstances. [Emphasis added]

25. An expert in a particular field is not required to exercise a greater degree of care than an ordinary person unless holding themselves out as an expert in that field. In *Case W3* Judge Barber said:<sup>9</sup>

[113] ... There may be varying degrees of care required depending on the particular circumstances. An expert in a particular field is not required to exercise a greater degree of care than an ordinary person unless holding himself (or herself) out to be such. *Stokes v Guest, Keen & Nettlefold (Bolts & Nuts) Ltd* [1968] 1 WLR 1776. An inexperienced person must exercise the care of an ordinary person *Nettleship v Weston* [1971] 2 QB 691 at p 699 per Lord Denning. ... [Emphasis added]

26. One of the issues in *Case W3* was whether a chartered accountant in private practice preparing tax returns for clients and accounting for GST had taken reasonable care in taking a tax position in their own GST returns. Judge Barber held the taxpayer had not taken reasonable care taking into account that they were an experienced chartered accountant and more could be expected of their accounting and record keeping practices than of some other individual.<sup>10</sup>

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<sup>9</sup> See also *Case W4* at [62] and *Case Y21* at [74].

<sup>10</sup> *Case W3* at [112].

27. Similarly, in *Brown v CIR*, a chartered accountant who prepared and reviewed tax returns for clients was held to a higher standard of care when attending to their own tax matters than a person with ordinary skill. McKenzie J said he agreed with the Taxation Review Authority that the taxpayer could be expected to have a high level of knowledge and experience regarding business transactions and the tax legislation.<sup>11</sup> As an accountant, the taxpayer was in a position to research relevant tax law and take advice. McKenzie J said:<sup>12</sup>

[11] The Authority held that a shortfall penalty was payable because the taxpayer did not take reasonable care in taking the tax position which he did when claiming a deduction for the amounts paid to the bank. On this, the Judge said:

**The disputant is a partner in a firm of chartered accountants and is a member of the New Zealand Institute of Chartered Accountants. As an accountant, he was involved at relevant times in preparing and/or reviewing financial accounts and income tax returns for clients. In doing this work the disputant is obliged to maintain competency standards and otherwise comply with appropriate technical and professional standards. In his evidence before the Authority the disputant stated that he gave tax advice to clients.** The firm's website also refers to his areas of expertise as including: "tax minimisation, succession planning and restructuring businesses". As well, the disputant was a businessman with extensive farming interests. **I agree with the Commissioner's submission that the disputant could be expected to have had a high level of knowledge and experience regarding business transactions and the tax legislation relating to interest deductibility.** The disputant says that if he was wrong to make the deductions then that error arose from an error of law where he had a reasonable argument supporting his stance.

The disputant did not produce any evidence as to the steps which he took to ascertain the correct tax position. **As an accountant, he was in a position to research the law on interest deductibility and to take advice (including legal advice as to the operation of the various guarantees in place).** Taking the above matters into account I accept the Commissioner's contention that the disputant has not acted as a reasonable person would have in the same circumstances.

[12] I agree entirely with the Judge. Her conclusions on the imposition of a shortfall penalty were correct, for the reasons she gave. There is nothing that I need to add.  
[Emphasis added]

28. In summary, a taxpayer is required to exercise the level of care expected of a reasonable person in the same category of taxpayer and circumstances as the taxpayer.

### **Other factors indicating a lack of reasonable care**

29. Other factors indicating a lack of reasonable care include:

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<sup>11</sup> *X (Chartered Accountant) v CIR* [2013] NZTRA 03, *Case 3/2013* (2013) 26 NZTC ¶2-002. The Taxation Review Authority became the Taxation and Charities Review Authority on 5 July 2024 (see s 4 of the Charities Amendment Act 2023).

<sup>12</sup> Footnotes omitted.

- repeated errors where the taxpayer has been advised or is otherwise aware that they have previously made mistakes but takes no action; and
- systems failures where the risks were foreseeable, but the taxpayer had not established adequate safeguards and monitoring to address them.<sup>13</sup>

30. For a business taxpayer, Inland Revenue will take into account the taxpayer's tax governance practices (that is, their tax policies, procedures and controls) when considering whether the taxpayer has taken reasonable care.<sup>14</sup>

### Following Inland Revenue advice

31. A taxpayer who asks for, and follows, Inland Revenue advice after disclosing full and correct facts takes reasonable care. As a taxpayer has the onus of proving they have taken reasonable care, they should document any oral advice from Inland Revenue, showing details of when and from whom they sought the advice, and retain any written advice from Inland Revenue.

### Delegation

32. Where a taxpayer delegates matters relating to taking a tax position to an officer or employee, the taxpayer is liable if the officer or employee does not take reasonable care.<sup>15</sup> Whether the taxpayer has exercised reasonable care in making the delegation may also be considered. For example, where an employer delegates responsibility to an employee who a reasonable person in the circumstances would have known or suspected was inexperienced or inadequately supervised or trained, the employer may not have taken reasonable care.

### A taxpayer relying on the actions or advice of a tax advisor

33. Generally, a taxpayer who relies on an action or advice of their tax advisor in taking a tax position takes reasonable care. Exceptions to this are 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

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<sup>13</sup> *Case W4* at [64].

<sup>14</sup> Click on this link to the Inland Revenue website for more information on tax governance and what Inland Revenue looks for in a tax control framework: [How to get tax governance right in New Zealand](#)

<sup>15</sup> *Canadian Pacific Railway Co v Lockhart* [1942] 2 All ER 464 (PC) at 467; *Union Steam Ship Company of New Zealand v Colville* [1960] NZLR 100 (CA); *Various Claimants v WM Morrison Supermarkets plc* [2020] UKSC 12. See also S Todd, *Todd on Torts* (9th ed, Thomson Reuters, Wellington, 2023), ch 21.

- 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.
34. If any of the exceptions apply, the taxpayer may be liable to a shortfall penalty for not taking reasonable care despite relying on the action or advice of their tax advisor.
35. Section 141A(2B) provides:

- (2B) A taxpayer who, in taking a tax position, relies on an action or advice of a tax advisor engaged by the taxpayer, or by a company in the same group of companies as the taxpayer, takes reasonable care in relying on the action or advice except if the taxpayer—
- (a) is the employer of the tax advisor:
  - (b) does not provide to the tax advisor adequate information relating to the tax position:
  - (c) does not provide to the tax advisor adequate instructions relating to the tax position:
  - (d) has reason to believe that the action or advice is incorrect:
  - (e) has previously, for a period ending less than 4 years before the beginning of the period to which the tax position relates, had a tax shortfall for the same type of tax arising from a corresponding tax position and does not take reasonable care to avoid the further tax shortfall.

36. A “tax advisor” is a natural person who is subject to the code of conduct and disciplinary procedures of a group of advisors that has a significant function of giving tax advice and is approved by the Commissioner, such as Chartered Accountants Australia and New Zealand.<sup>16</sup> Section 20B provides:

- ...
- (4) A tax advisor is a natural person who is subject to the code of conduct and disciplinary process, referred to in subsection (5)(a)(ii) and (iii), of an approved advisor group.
- (5) An approved advisor group is a group that—
- (a) includes natural persons who—
    - (i) have a significant function of giving advice on the operation and effect of tax laws; and
    - (ii) are subject to a professional code of conduct in giving the advice; and

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<sup>16</sup> The list of advisor groups approved by the Commissioner is published on the Inland Revenue website: [approved advisor groups](#).

- (iii) are subject to a disciplinary process that enforces compliance with the code of conduct; and
- (b) is approved by the Commissioner for the purposes of this definition.

37. To have taken reasonable care, a taxpayer does not necessarily have to have relied on the action or advice of a “tax advisor”.<sup>17</sup> Taxpayers who rely on a “tax agent” or bookkeeper who is not a “tax advisor” may have taken reasonable care.<sup>18</sup> This may be the case where the tax agent or bookkeeper is someone a reasonable person would regard as reputable, the taxpayer engages and pays the tax agent or bookkeeper for their services, adequately informs them, and has no reason to believe their actions or advice are incorrect.
38. Also, other steps a taxpayer takes to understand their tax obligations will be enough if those steps are what a reasonable person would do given the complexity and exceptionality of the tax position. For example, generally a taxpayer with relatively simple tax affairs, such as a salary and wage earner, would reasonably be expected to consider relevant tax guides and other information freely available on Inland Revenue’s website ([www.ird.govt.nz](http://www.ird.govt.nz)) and to seek clarification if necessary.
39. What constitutes reasonable care for a taxpayer using artificial intelligence in taking a tax position depends on how the technology is used and applied. For example, when faced with a complex tax question, it would not be taking reasonable care to use a single prompt to a general-purpose artificial intelligence system and rely solely on its response. Taking reasonable care when using artificial intelligence involves the use of accurate facts, checking sources are verified and trusted (such as legislation, case law, and Inland Revenue rulings and other guidance), and reviewing outputs for accuracy and applicability in the circumstances.

### **A taxpayer who takes an acceptable tax position takes reasonable care**

40. A taxpayer who takes an “acceptable tax position” takes reasonable care. Section 141A(3) provides:

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<sup>17</sup> *Hong v CIR (CA)*.

<sup>18</sup> A “tax agent” is a person who prepares income tax returns for 10 or more persons and carries on a professional public practice or business, is carrying on a business, occupation, or employment in which returns of income are prepared and filed, and/or is the Māori Trustee (s 124C). The person may apply to be listed with the Commissioner as a “tax agent”.

- (3) A taxpayer who takes an acceptable tax position is also a taxpayer who has taken reasonable care in taking the taxpayer's tax position.

41. An "acceptable tax position" is defined in s 3(1) as a tax position that is not an "unacceptable tax position". The meaning of "unacceptable tax position" is explained in [IS 26/05: Shortfall penalty for taking an unacceptable tax position](#). In summary, an "unacceptable tax position" is one that, viewed objectively, fails to meet the standard of being "about as likely as not to be correct".<sup>19</sup> Whether the taxpayer believes their tax position was correct or acceptable is irrelevant. A taxpayer's tax position will meet the "about as likely as not to be correct" standard if:<sup>20</sup>
- even though wrong, it can be argued on rational grounds to be right;
  - it is one on which "reasonable minds could differ". There must be room for a real and rational difference of opinion;
  - it has about an equal chance of being correct.

### Mistakes in the calculating or recording of numbers

42. A taxpayer does not take an "unacceptable tax position" by making a mistake in calculating or recording numbers used in, or for use in preparing, a return.<sup>21</sup> However, s 141A(3) is subject to the qualification that a taxpayer who makes such a mistake is not excluded from being liable for a penalty for not taking reasonable care. Section 141A(4) provides:

- (4) Subsection (3) and section 141B(1B) do not exclude a taxpayer who makes a mistake in the calculation or recording of numbers in a return from being liable for a penalty for not taking reasonable care.

43. Accordingly, even though a taxpayer who makes a mistake in calculating or recording numbers in a return does not take an "unacceptable tax position", they may still be liable for a shortfall penalty for not taking reasonable care.

### Examples

44. Example | Taura 1 and Example | Taura 2 illustrate the kind of mistakes for which a taxpayer may be liable for a penalty for not taking reasonable care. Example | Taura 3

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<sup>19</sup> Section 141B; *TRA 010/18* at [61].

<sup>20</sup> *Ben Nevis Forestry Ventures Ltd & Ors v CIR; Accent Management Ltd & Ors v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188 at [184] and [185]; *TRA 010/18* at [62].

<sup>21</sup> Section 141B(1B).

illustrates the kind of circumstance where a taxpayer who relied on the advice of its tax advisor may be treated as having taken reasonable care. Example | Taura 4 and Example | Taura 5 illustrate the kind of circumstance where a taxpayer who relied on the advice of their tax advisor may not be treated as having taken reasonable care.

### **Example | Taura 1 – Repeated transposition error made by staff member**

A staff member of a business makes a transposition error when entering an amount into the business' accounting software. The error is carried through into the business' GST return and there is a \$10,000 tax shortfall. The owner of the business is aware that the same staff member has made similar transposition errors before. However, the owner has not taken any steps to reduce the risk of transposition errors. They have not arranged any supervision of, or training for, the employee. They did not check the GST return before it was filed.

In the circumstances, a reasonable business owner would have foreseen a risk and put simple checks in place to reduce the risk of transposition errors. The business owner did not do so. The business owner has not taken reasonable care.

### **Example | Taura 2 – Taxpayer did not take reasonable care**

The taxpayer is an experienced tax accountant in private practice preparing financial statements and tax returns for clients.

When the taxpayer's own tax affairs were audited, Inland Revenue found the taxpayer's records in disarray. After further investigation, it was established the taxpayer had overlooked returning some income for the tax year under audit. The taxpayer was also unable to provide supporting information to show they were entitled to some of the expenses claimed as deductions. There was a tax shortfall.

A reasonable person with the same skill and experience as the taxpayer (a practising tax accountant) would have appropriate accounting and record-keeping systems in place. They would have seen the risk of a tax shortfall if their records were in disarray and kept them in good order. Good accounting and record-keeping practices are not onerous, especially for a reasonable person of the taxpayer's skill and experience. The taxpayer has not taken reasonable care.

**Example | Taura 3 – Company relying on the advice of a tax advisor took reasonable care**

A GST-registered company claimed an input tax deduction for a significant, one-off expense. The input tax deduction was not justified, the tax position taken when the company filed its GST return was incorrect and there was a tax shortfall.

Prior to filing the GST return, the company had sought and received advice from its accountant that an input tax deduction was available for the expense. The company's accountant was an experienced tax accountant and a member of an approved advisor group. The company had fully informed and instructed the accountant about the nature of the expense, had no reason to believe the accountant's advice was incorrect, and had not previously had a tax shortfall for GST.

The company has taken reasonable care. It relied on the advice of its tax advisor and none of the exceptions in s 141A(2B) applies.

**Example | Taura 4 – Taxpayer provided insufficient information to tax advisor**

A taxpayer decides to change banks. It opens a business account with a new bank and receives sales income into the account from the first day of a new income year. For the first two months of the income year the taxpayer also receives some sales income into the business account at their old bank before the account is closed.

The taxpayer uses a tax advisor to prepare their income tax return. At the end of the income year, the tax advisor asks the taxpayer for their bank statements. The taxpayer delegates the task of collating and providing their bank statements to a new employee. The new employee sends the tax advisor the bank statements for the taxpayer's account with the new bank but does not include statements for the taxpayer's account with their old bank. The tax advisor prepares the taxpayer's income tax return omitting the two months of sales income received into the taxpayer's account with their old bank. Before filing the income tax return, the tax advisor sends a copy to the taxpayer to check. The taxpayer approves the return without checking it, assuming it is correct. The return is filed and there is a tax shortfall.

The taxpayer has not taken reasonable care. A reasonable person in the taxpayer's position would have checked the information the inexperienced employee collated and provided to the tax advisor, and checked the income tax return prepared by the tax advisor before it was filed. Although the taxpayer has used a tax advisor to prepare their income tax return, the taxpayer did not provide the tax advisor with adequate

information. Accordingly, s 141A(2B) will not apply to treat the taxpayer as having taken reasonable care.

### **Example | Taura 5 – Company did not take reasonable care**

A company carries on a business buying and selling land. It engages in numerous sizeable land transactions and has an average annual turnover of \$10 million. The company's directors are experienced in carrying on the company's business. The company used a tax advisor to prepare its financial statements and income tax returns.

One of the directors purchased some land as nominee for the company. The company reimbursed the director for the \$1,450,000 purchase price of the land.

The following income year, the director sold the land on behalf of the company. The \$1,575,000 sale proceeds were initially received into the director's bank account and the company overlooked returning them as income.

The company had no systems in place to ensure all property sales and purchases were recorded. In addition, it had no process for reconciling property purchases with property sold or held to ensure income was returned for tax purposes as required.

The company did not advise its tax advisor that the property had been sold, nor did it check that the sale was shown in the financial statements and income tax return the tax advisor prepared for the year of sale.

The property was one of five the company sold in the relevant income year. The company's total tax liability for the year was \$140,000.

The company took a tax position when its income tax return was filed and there was a \$35,000 tax shortfall.

A reasonable person in the circumstances (of being involved in numerous sizeable land transactions) would:

- understand how tax laws applied to their property transactions, including the nominee arrangement, and that the \$1,575,000 sale proceeds were assessable income of the company;
- have systems in place to ensure all property sales and purchases were recorded with a process for reconciling property purchases with property sold or held, with the result that income would be returned as required;
- have seen a tax shortfall as likely if the sale proceeds were not returned as income – given the mismatch with the deduction for the cost of the property taken in the prior income year, the size of the tax shortfall when

compared with the company's total tax liability, and the number of property transactions for the relevant year; and

- have advised their tax advisor the property had been sold and checked the financial statements and income tax return prepared by their tax advisor to ensure they included the sale.

The company has not done what a reasonable person would have done in the circumstances.

Although it used a tax advisor to prepare its income tax returns, the company did not inform its tax advisor of the sale transaction.<sup>22</sup>

The tax position the company took when its tax return excluded the sale proceeds was not an "acceptable tax position".<sup>23</sup> It was not "about as likely as not to be correct". That the sale proceeds were income that should have been returned for tax purposes was not something on which reasonable minds could differ.

The company has not taken reasonable care. The taxpayer may also have been grossly careless, in which case a shortfall penalty for gross carelessness may apply.<sup>24</sup> In that case, the higher penalty, a shortfall penalty for gross carelessness, would be imposed.<sup>25</sup>

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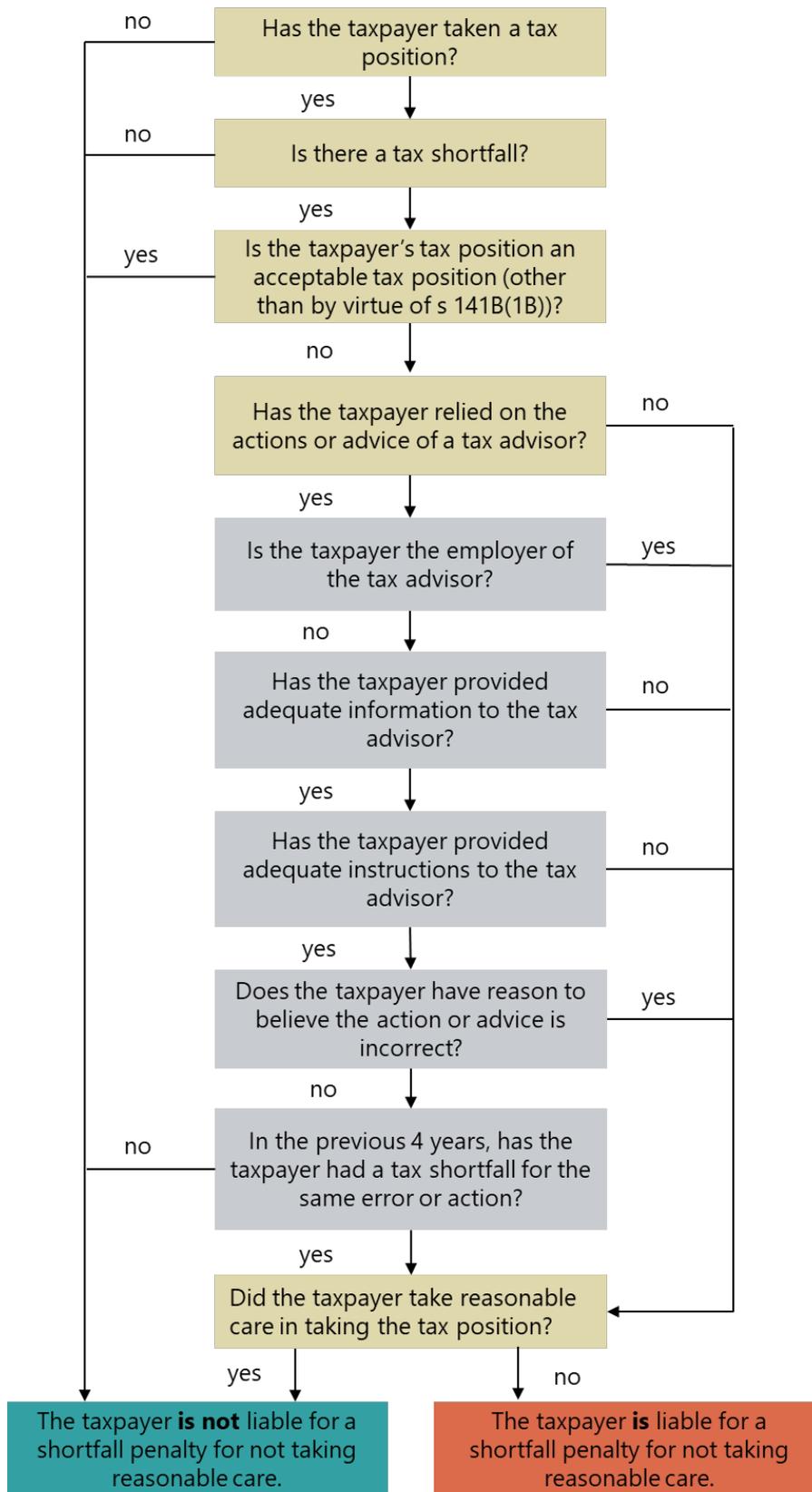
<sup>22</sup> Section 141A(2B); see [33]–[37].

<sup>23</sup> As noted in [40] and [41], a taxpayer who takes an "acceptable tax position" takes reasonable care.

<sup>24</sup> See IS 26/06: Shortfall penalty for gross carelessness.

<sup>25</sup> See IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

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



## References | Tohutoro

### Legislative references | Tohutoro whakatureture

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## Other references | Tohutoro anō

IS 26/05: Shortfall penalty for taking an unacceptable tax position

[taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-05](https://taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-05)

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IS 26/09: Shortfall penalties – reductions and other matters

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S Todd, *Todd on Torts* (9th ed, Thomson Reuters, Wellington, 2023), ch 21

## About this document | Mō tēnei tuhinga

Interpretation statements are issued by the Tax Counsel Office. They set out the Commissioner’s views and guidance on how New Zealand’s tax laws apply. They may address specific situations we have been asked to provide guidance on, or they may be about how legislative provisions apply more generally. While they set out the Commissioner’s considered views, interpretation statements are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further [Status of Commissioner’s advice](#) (Commissioner’s statement, Inland Revenue, December 2012). It is important to note that a general similarity between a taxpayer’s circumstances and an example in an interpretation statement will not necessarily lead to the same tax result. Each case must be considered on its own facts.