

ATO RECEIVABLES POLICY

PART B The Collection of Taxation Debts

Chapter 27

COMPROMISE OF TAXATION DEBTS

The policy in this chapter is to be followed by Tax Office staff. We have made every effort to ensure it is technically accurate, but in the interests of clarity it has been written in 'plain English' and should not be read or interpreted like legislation. If you feel that something in the chapter is wrong or misleading, please advise the Tax Office.

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Key legislation: various

PURPOSE

1. This chapter deals with the Tax Office's approach to resolving undisputed taxation debts by compromise arrangements.
(However, it does not apply to securities obtained in relation to the *Excise Act 1901*.)

INTRODUCTION

2. Debtors have a responsibility to meet their payment obligations as and when they fall due for payment. Where a debtor does not pay by the due date, the Tax Office has a full range of collection options. These include, in appropriate cases, compromising the debt.
3. The Commissioner has the power to compromise an undisputed tax debt in terms of section 255-5 in Schedule 1 to the *Taxation Administration Act 1953* (TAA) in combination with:
 - Section 8 of the *Income Tax Assessment Act 1936* (ITAA 1936)
 - Section 3A of the TAA
 - Section 356-5 of the TAA (covers indirect tax laws including GST law, Wine Tax law, Luxury Car Tax law, Fuel Tax law)
 - Section 111 of the *Sales Tax Assessment Act 1986*
 - Section 3 of the *Fringe Benefits Tax Assessment Act 1986*
 - Section 43 of the *Superannuation Guarantee (Administration) Act 1992*
 - Section 30 of the *Superannuation Contributions Tax (Assessment and Collection) Act 1997*
 - Section 26 of the *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997*

- Section 21 of the *Termination Payments Tax (Assessment and Collection) Act 1997*
- Section 6A of the *Diesel and Alternative Fuel Grants Scheme Act 1999*
- Section 3 of the *Distillation Act 1901*
- Section 7 of the *Excise Act 1901*
- Section 7 of the *Product Grants and Benefits Administration Act 2000*

4. This chapter provides guidance for deciding what is an appropriate case, under the following headings:

- cases where the Tax Office will not compromise a debt
- cases where the Tax Office may compromise.

POLICY

CASES WHERE THE TAX OFFICE WILL NOT COMPROMISE A DEBT

5. The Tax Office will not compromise a taxation debt in some circumstances. The following paragraphs, which are not intended to be exhaustive, identify a number of circumstances where the Tax Office will not compromise a debt.

A. All requests must be in writing

6. The Tax Office will not consider oral requests for compromise; requests must be in writing. The onus is on the debtor to establish that the debt should be compromised.

7. Any proposal for compromise should be signed and should be supported by:

- a detailed statement of all assets and liabilities (in Australia and overseas)
- a detailed statement of income (including capital receipts) and its source(s) relating to the previous 12 months, and
- a detailed statement of expenditure (including capital expenditure) relating to the previous 12 months, including how the expenditure is funded if total expenditure exceeds total income

for the debtor and associated family members and entities where appropriate. Depending on the case, the details sought for the above could include information about earlier periods.

8. The statement should set out the debtor's reasons for seeking a compromise and be accompanied by evidence supporting the debtor's claims for not being able to make full payment, for example, evidence of attempts to obtain funds to pay the debt, evidence of loan refusals. The statement should also incorporate details of:

- (i) interests in real or personal property or money disposed of (other than for normal living expenses or in the ordinary course of business) in the preceding 3 years or such longer period as may be considered appropriate by the Tax Office in a particular case
- (ii) the value of the property at the date of disposal or the amount of money disposed of, the consideration received, the identity of the

person who acquired the property and the relationship between the debtor and the person who acquired the property, if any

- (iii) the debtor's possible future interests in property or money, whether certain or contingent or arising from the possible exercise of a discretion by another
- (iv) all property and income over which the debtor either alone or with others has any direct or indirect power of appointment or disposal, whether as trustee or otherwise
- (v) details of entities the debtor controls, either alone or together with others, and
- (vi) the debtor's present sources and level of income and the anticipated sources and level of income for the foreseeable future, with an outline of the debtor's plans for the future.

9. Forms are available for individual and corporate taxpayers which seek this information in a structured format. Debtors should complete this form in lieu of providing information in an unstructured format, or only providing information which they consider relevant.

10. An accurate assessment of the position must be based on a detailed knowledge of the financial affairs of the debtor (past, present and future) and other matters which touch upon them. It will generally be necessary to rely upon the debtor to provide that knowledge and it is fundamental that debtors and their advisers provide a full and frank disclosure of all relevant information. Officers may draw adverse inferences where debtors either fail to supply information, or provide inadequate information, concerning any matter relevant to their compromise application. Any failure or unreasonable delay in supplying information should result in the termination of negotiations and the initiation or continuation of normal recovery processes.

B. The Tax Office will not accept compromise proposals that offer less than the debtor's total net assets in full satisfaction of the taxation debt.

11. Bankruptcy law and the law relating to seizure of property in execution exempt from this obligation certain basic necessities like clothing, furniture, tools of trade and the like. Subject to these exemptions, any compromise offer will be expected to consist of no less than the full value of the whole of the debtor's present property.

12. The same condition applies to corporate debtors. Because of this, it is unlikely that many corporate debtors will seek to compromise their debts. They will probably seek an arrangement with creditors under Part 5.3A of the *Corporations Act 2001* or go into liquidation. Both of these options are discussed in separate chapters in this Policy. Where a corporate debtor is contemplating a compromise, enquiries should be made to ascertain whether the debtor or its principals have engaged in conduct that satisfies condition (E) discussed below (that is, the Tax Office will not consider requests for compromise where this may directly or indirectly impact on other actions involving the debtor or other parties).

C. The Tax Office will not prejudice other creditors, nor accept that other creditors can prejudice the Tax Office's entitlements.

13. It is necessary to ensure that the proposed compromise does not disadvantage any other creditor(s). Such a proposal should be refused unless it can be shown that all affected creditors consent to the arrangement. On the other hand, a proposal involving payment to the Tax Office of funds provided by a third party (for example, a relative) and not in payment for any of the debtor's property, would not disadvantage any other creditor.
14. In considering whether or not to enter into a compromise, it is also prudent to carefully examine the position in relation to other creditors. Firstly, the Tax Office will not consider a proposal if another creditor intends to take, or has initiated, formal recovery proceedings. Secondly, it is necessary to ensure that whatever arrangements have been, or are proposed to be, made in relation to other creditors (or in relation to some of them) do not place them in a position of advantage relative to the Commonwealth. Proposals where the Commissioner is the only creditor should receive very close scrutiny.
15. Insolvency law now treats almost all taxation debts as ranking equally with other ordinary unsecured debts and there is no reason why, in the context of a voluntary compromise, the Tax Office should accept anything less. In the case of those debts which still retain a statutory priority, that is, tax instalment deductions and certain other source deduction liabilities which fell due before 1 July 1993, the compromise proposal must preserve the Commissioner's preferential status. The existence of a priority does not alter the principle that the Tax Office will not act in a way that prejudices other creditors. The proposal (including any priority) will be void if there is evidence that some creditors will be treated differently so as to amount to an unfair preference or a voidable transaction (*Smith v. DFC of T* 97 ATC 4471).
16. There would, of course, be no objection to creditors, such as former employees with claims for wages, who would enjoy priority in a formal administration under insolvency law, being given an equally preferred status under the proposed compromise terms.

D. The Tax Office will not consider requests for compromise involving debts raised by assessments etc. that are subject to dispute, where an application to waive the debt has not been finalised, or where an application for release from payment of an income tax or fringe benefits tax debt has not been finalised.

17. The Tax Office must know the amount of the debt before making any compromise decision.
18. It has long been accepted that the Commissioner has the administrative power under provisions such as section 8 of the ITAA 1936 in combination with section 255-5 of Schedule 1 to the TAA to reach an out-of-court settlement concerning the amount which a taxpayer is or will be liable to pay in a case where there is a genuine dispute about the actual amount of a liability.
19. In most cases, the terms of settlement are given effect by the issue of assessments or amended assessments on an agreed basis and those assessments thereafter determine for all purposes the amount of a taxpayer's liability.

E. The Tax Office will not consider requests for compromise where this may directly or indirectly impact on other actions involving the debtor or other parties.

20. In respect of the recovery of penalties from company directors under Division 9 of Part VI of the ITAA 1936, compromise can only be considered where options against the company are exhausted and there are no director penalty notices outstanding for the same debt against other directors. Compromise is unavailable in situations where a director penalty notice liability exists for more than one director. Where there is no longer a parallel liability with the company or any other director, a compromise offer may be considered. In that event the compromise would encompass all debts owed by the debtor, that is, a director against whom action is being taken to recover a director penalty notice amount may also have a personal income tax debt. Defaulted payment agreements would have similar considerations. Note that debts covered by reparation orders cannot be compromised.
21. Compromise is rarely available in situations where more than one member of a consolidated group under Division 721 of the *Income Tax Assessment Act 1997* (ITAA 1997) is jointly and severally liable for the same debt because the Tax Office may recover from other members of the consolidated group. Where a contributing member is liable for an amount under a tax sharing agreement, compromise will not be considered until all options against the head company have been exhausted. An offer of compromise made by either the head company or a contributing member may be considered by the Tax Office once all options against each jointly liable party have been exhausted.
22. It is open to the debtor to seek to compromise their debts once these actions are completed. Note that, as advised above in the discussion on disputes, these rights also could be compromised where there is a demonstrable benefit to the revenue. In that event, the compromise of these other actions could include terms to encompass all debts owed by the debtor and other parties. For example, a director against whom action is being taken to recover a director's penalty may also have an income tax debt. In appropriate cases, the Tax Office may compromise both debts. Where this occurs, the debtor and the other parties would normally be made parties to the compromise arrangement by way of deed.

- F. The Tax Office will not accept compromise proposals where the taxation affairs of the debtor are not up to date.**
23. The Tax Office must know the amount of the debt before making any compromise decision. Lodgments must be up to date.
- G. The Tax Office will not accept compromise proposals where the only reason to support the proposal is the debtor's claim of hardship in paying their taxation debts.**
24. Considerations of hardship cannot justify the exercise of the power to compromise. Parliament has laid down in some taxing statutes a specific procedure for dealing with hardship cases and this procedure has clearly displaced any authority the Commissioner may have impliedly had to deal with them under the general administrative power.
25. At the same time, hardship considerations cannot justify the exercise of the power to compromise in the case of those statutes which contain no provision for release on grounds of hardship. It is unlikely the power of general administration of those particular statutes was bestowed upon the Commissioner for the purpose of alleviating hardship.

26. Thus if, for example, a debtor's total resources were equal to the tax liability, the fact the debtor must dispose of a home and a source of income (be it a business or investments) and all other assets and property in order to pay will not justify accepting less than the full amount as full payment of the debt. Debtors have a responsibility to manage their affairs to ensure funds are available to meet tax debts. The fact they may have used funds to acquire assets instead of setting those funds aside to meet their tax debts is no reason for the Tax Office to accept anything less than the full amount.

H. The Tax Office will not accept compromise proposals where aspects of a debtor's payment history have been very poor.

27. This criterion focuses on certain aspects of that history, particularly whether the debtor has been candid about their financial affairs and their attitude towards meeting their taxation obligations in that financial environment. An agreement to compromise a debt is essentially based on trust. The Tax Office will be relying heavily on the representations of the debtor. Where a debtor has a history of insincerity or dishonesty, providing misleading or incomplete information, declining to provide any information, or failing to enter/honour reasonable agreements to pay their debts over time in the past without reasonable cause, the Tax Office will not enter into a compromise agreement with that debtor. The disciplines of bankruptcy may be the appropriate response to the risks inherent in dealing with these debtors.

I. The Tax Office will not accept compromise proposals unless there is a benefit in doing so, over and above the return that would flow from taking actions under either the *Bankruptcy Act 1966* or the *Corporations Act 2001*.

28. There are two aspects to this statement. Firstly, it could sometimes be argued that the Tax Office should accept something less than this, because if it does not, it will suffer the expense and delay of legal proceedings necessary to forcibly realise property and the like.

29. This argument is not accepted because to do so would be to reward behaviour which amounts to non-compliance with the debtor's obligations. This would be wholly inconsistent with the objective of achieving a high level of voluntary compliance by the community generally. However, due allowance can be made for the legitimate costs associated with the realisation of an asset which are not attributable to any active obstruction (or inaction) on the part of the debtor.

30. The second aspect is what Tax Office cost savings are relevant in calculating any benefit. Only future cost savings are relevant. Debtors who defer discussing their affairs with the Tax Office until they are at the door of the Court will have little chance of their proposals being accepted as the Tax Office has already committed itself to expenditure.

J. The Tax Office will not accept compromise proposals where it may reflect adversely on taxpayer compliance.

31. In deciding how to administer the taxation law, the Tax Office manages risks. High risk taxpayers include those who continually participate in aggressive tax planning arrangements, regularly lodge their taxation returns late or who pay their taxation debts late and then only after some prompting, or not at all, or for example, are frequently late in forwarding their withholding payments. The conduct of high risk debtors excludes them from compromise agreements.

K. The Tax Office will not accept a compromise proposal where the debtor could lodge a debt agreement under Part IX of the *Bankruptcy Act 1966*.

32. As debt agreements offer the same benefits to debtors as compromise agreements, but at less cost to the Tax Office, the Tax Office will not consider compromise proposals where the debtor meets the requirements of, and can lodge, a debt agreement proposal with the Insolvency and Trustee Service of Australia (ITSA).

L. The Tax Office will not accept a compromise proposal where the debtor, within 5 years immediately before the proposal, has:

- been a party to an earlier compromise agreement with the Commissioner
- been a bankrupt, or
- been a party to an arrangement under Part IX or Part X of the *Bankruptcy Act 1966* or Part 5.3A of the *Corporations Act 2001*.

33. The above arrangements within taxation, bankruptcy law and corporations law provide for different forms of insolvency administration for debtors that relieve the debtor from the burden of their debts so that they can start afresh. In deciding how to collect taxation debts, the Tax Office manages risks. Debtors that seek to be relieved of their debts within this time period are too high a risk for compromise agreements.

Communicating with debtors

34. Where feasible, at the initial stage, the Tax Office will advise debtors interested in compromising their debts of the stringent requirements that must be satisfied in order to obtain a compromise agreement, and of the actions the Tax Office may take if a compromise proposal is not accepted.

35. When debtors lodge a written application for a compromise, they are essentially admitting that:

- they are insolvent
- they may have been insolvent for some time, but now do not see this situation improving, and
- in some cases, they have paid out other creditors to the detriment of the Tax Office (probably an act of bankruptcy under the *Bankruptcy Act 1966*).

36. The Tax Office is entitled to use any information in its possession when evaluating the risks inherent in particular debts and in considering which recovery action to take on those debts. Evidence of insolvency implies very high risk. If a compromise proposal is not accepted, consideration ought to be given to:

- initiating or pursuing action to bankrupt the debtor
- issuing a demand notice under section 459E of the *Corporations Act 2001* to the debtor
- commencing action for insolvent trading under the *Corporations Act 2001*, and/or
- issuing director penalty notices (if appropriate).

37. Where debtors raise the possibility of compromise in discussions, they should be advised the Tax Office may use that information when considering what recovery action to take. If there is a significant risk to the revenue, action could be taken, on the basis of the oral comments, to protect the revenue.

CASES WHERE THE TAX OFFICE MAY COMPROMISE A DEBT

38. Section 3A of the TAA in combination with section 255-5 of Schedule 1 to the TAA and equivalent provisions of other tax statutes administered by the Commissioner enable him to compromise undisputed debts (agree to a 'commercial' settlement). However, the power to compromise is not an unfettered power to accept a lesser sum in full satisfaction of a debtor's indebtedness for any reason which the Commissioner thinks is appropriate.

39. It is a power which can only be properly exercised if it is exercised for a permissible purpose. The fundamental purpose of the general administration power is to enable the collection of taxation liabilities from those who are obliged to pay them.

40. The Commissioner's power to compromise must be exercised in accordance with the purpose of the taxation legislation, that is, to secure the highest net return taking into account considerations of good management and/or administrative common sense. In view of this, it would be unusual for the Tax Office to compromise a debt outside the statutory processes available under the bankruptcy and corporations laws unless it is satisfied that result would not be available without the compromise.

41. That benefit might take the form of a saving in the costs of collection, collection at an earlier date than would otherwise be the case, collection of a greater sum than could be otherwise recovered or abandonment by the debtor of some claim or right arising under a taxation law that has a monetary value (for example, the right to carry forward losses). Consideration will not be focused solely on the short term benefits and costs. Longer term considerations such as general compliance with taxation legislation are also relevant. Any immediate benefit of cost savings may be offset many times over if the debtor's compliance history is poor.

42. Thus, if considerations of good management or administrative commonsense lead the Tax Office to conclude that the most efficient way in which to achieve the purpose of collecting taxation liabilities correctly payable is to reach a compromise, then it is appropriate to compromise.

43. Likewise, if in a particular case, the Tax Office concludes that more tax can be recovered by entering into a compromise than by pursuing alternative remedies, such as agreeing to accept payment over an extended period of time or instituting legal proceedings leading to bankruptcy or liquidation, then it may decide that compromise is the most appropriate step to take.

44. On the other hand, considerations which are **not** directly related to the Tax Office's function of collecting taxes cannot justify the use of the power to compromise. For example, it would not be permissible to compromise to:

- assist those debtors who may have overcommitted themselves
- save a business from closure because a large number of people in a particular region depended on the business for employment

- avoid the failure of a business because the activities of the business might be seen to be serving a national interest (for example, a large exporter, a producer of a key raw material or product)
- alleviate what may be perceived to be a harsh or unfair operation of a tax law in particular circumstances
- avoid hardship (such as the need to sell a home or a business), or
- create for the Commissioner a benevolent public image or in the furtherance of some charitable objective.

Limitations on the Commissioner's ability to compromise.

45. In a private agreement between a creditor and a debtor which involves acceptance of a lesser sum in full satisfaction of a debt, the creditor, in consideration for payment of the lesser sum, would usually grant a legal discharge of the balance of the debt such that, in law, it no longer existed.
46. The Commissioner, however, does not have the same power. For taxation debts, it is the Commonwealth (not the Commissioner) that is the creditor. The Commissioner is simply the agent through which the Commonwealth acts to collect.
47. Where the Commissioner has an express power to either reduce, remit or forgive any taxation debt, all relevant legislation, guidelines and policy in respect to that power should be followed in the first instance. It is only after this course of action has been exhausted that the matter can be considered in accordance with the compromise guidelines. An example is a case involving additional charges for late payment/GIC.
48. Any purported grant of a discharge would be ineffective and would not prevent subsequent recovery of the debt. Consequently, it would be unacceptable to a debtor.
49. Many of the remedies available to the Commissioner to secure payment are discretionary rather than mandatory. Accordingly the Commissioner may use his judgment on how best to collect any tax debt. The Commissioner may decide not to exercise any or all of these discretionary remedies (that is, effectively compromise the debt) provided, in so doing, he is acting for reasons of good management or administrative commonsense so far as collecting the revenue is concerned.
50. The most appropriate mechanism for giving effect to a compromise is for the Commissioner to enter into a deed which would include a covenant that the Commissioner will not exercise any discretionary remedy to enforce payment. A covenant in these terms would be enforceable in law against the Commissioner.
51. There are limitations on the Commissioner's ability to compromise. The Commissioner cannot enter into an agreement to do something contrary to that prescribed by legislation. Any agreement attempting this would be ineffective at law. Nearly all the limitations are prescribed by mandatory terms in the legislation. These terms prescribe that the Commissioner must, not may, do something.
52. The limitations on compromising include:
 - Some provisions in tax law dealing with the application of credits show an intention that if there are other amounts owing in a particular case the Commissioner is obliged to set off the credit against them before

making any refund (see section 172 of the ITAA 1936, Division 3 of Part IIB of the TAA)

- A covenant by the Commissioner not to exercise or pursue discretionary remedies will not prevent the Commonwealth itself, or other agencies of the Commonwealth, such as the Director of Public Prosecutions, from exercising such powers or remedies as are separately available to it or them. Such remedies include recovery of unpaid amounts (or equivalent amounts) by way of reparation under the *Crimes Act 1914* or penalty under provisions such as section 12 of the *Crimes (Taxation Offences) Act 1980* or section 8W of the TAA, and
- The power of compromise is not available in the cases of higher education loan program (HELP) debts or student financial supplement (FS) assessment debts. The Commissioner does not have the general administration of either the *Higher Education Support Act 2003* (HESA) or the *Student Assistance Act 1973* (SAA), even though he is charged with responsibility for collection of liabilities arising under those Acts.

Nevertheless, the provisions of sections 154-45 and 154-50 of the HESA and 12ZP of the SAA, provide authority for the Commissioner to deal with any foreseeable circumstances by way of deferring or amending such assessments.

53. The only options available to a debtor who is not prepared to accept the qualifications to the Commissioner's ability to compromise in the first three dot points above are either to apply to the Commissioner for release, or apply to the Minister for Finance and Deregulation for a waiver of the balance of the debt. A debtor could also obtain a discharge of the debt (apart from HECS debt) by becoming subject to the processes available under the *Bankruptcy Act* or the *Corporations Act*.

Matters that should be considered

54. Generally, the avenues available to both creditors and debtors for dealing with debts under various statutes operate to effectively protect all parties and provide alternatives to bankruptcy/liquidation for debtors. Specific provisions of the bankruptcy and corporation laws act to protect the interests of ALL creditors, who each have the opportunity of voting on compromise proposals in cases where debtors offer payment of less than the full debt.
55. In this regard, it should be recognised that most informal arrangements or schemes proposed by debtors and agreed to by creditors suffer from difficulties of enforceability, but even more importantly, such arrangements do not bind dissenting creditors and in the case of non-corporate debtors, are voided by Part X of the *Bankruptcy Act 1966*.
56. There is a similar risk for corporate debtors. Payments made under compromise agreements have been found to be voidable transactions (in that they were unfair preferences under section 588FA of the *Corporations Act 2001* and insolvent transactions under section 588FC where the agreement may result in all creditors not being paid in a timely fashion by an insolvent company (*Smith v. DFC of T 97 ATC 4471*).
57. It is not possible to set out all of the circumstances which might arise in a particular case and which might justify entering into a compromise.

Nevertheless, there are some matters that need to be considered before deciding whether or not to compromise a taxation debt. These include:

- determining the potential return to the Commonwealth if there were no compromise
- what allowance should be made, if any, for tax losses that may be available, and
- determining the return to the Commonwealth if the compromise was accepted.

Determining the position without compromise

58. Bankruptcy law and the law relating to seizure of property in execution exempt certain basic necessities like clothing, furniture, tools of trade and the like, but subject to these exemptions, any compromise offer will be expected to consist of no less than the full value of the whole of the debtor's present property.
59. In making an assessment of what the position will be without a compromise, it is not only necessary to look at the value of the debtor's present property but also to examine the debtor's future prospects, past transactions and the position of any related entities. There is no time limit within which the Tax Office must recover tax debts and consequently it can have access to income derived and assets acquired for an unlimited period in order to obtain payment.
60. This assessment should proceed on the basis that the debtor will voluntarily pay over net current assets, current and future income not needed for meeting future tax debts or necessary living expenses during the currency of the deed together with other assets acquired up to three years after the date of the compromise agreement (this creates some alignment with the *Bankruptcy Act 1966*, for example, Div 4B of Part VI of the *Bankruptcy Act 1966* provides guidance with regard to the contribution the debtor could make. In other words, there should be no discounting for possible enforcement costs or delay due to the debtor's possible failure to voluntarily pay).
61. In considering the question of a debtor's future prospects, regard should be had to any arrangements which have been implemented or are proposed which might have the effect of diverting income or property that might otherwise accrue to the debtor, to other entities. Unless there are compelling reasons for the implementation of the particular arrangements and the diversion of income or property is unavoidable, compromise will not be accepted on the basis of the reduced income or property likely to be available. In these cases, the arrangements should be ignored for the purpose of calculating the value of the debtor's future income or property. This stand should be maintained even though, in the final analysis, the Tax Office might not, through bankruptcy or other legal remedies, be able to avoid the arrangements.
62. The overriding consideration is that the Tax Office should not be seen to condone arrangements which are detrimental to the revenue. To do so may encourage proliferation of such arrangements to the even greater detriment of the revenue.
63. A full assessment of the position as it would be without a compromise also involves a consideration of the application of bankruptcy and/or company law to the facts of the case. There are four broad areas in which bankruptcy law remedies can make available to creditors funds over and above the value of a debtor's present property. They are:

- (i) the 'clawback' of money or assets previously disposed of by way of preferences in favour of other creditors, voluntary settlement (that is, transfers of property for no, or inadequate, consideration) and fraudulent disposition (that is, property disposed of with intent to defeat or delay creditors)
- (ii) the recovery of money or assets held by entities controlled by the debtor (Division 4A of Part VI of the *Bankruptcy Act 1966*)
- (iii) the requirement that the bankrupt contribute to their estates from future earnings (refer Division 4B of Part VI of the *Bankruptcy Act 1966*), and
- (iv) the vesting of all divisible property, acquired by a bankrupt prior to discharge, in the trustee for the benefit of creditors.

64. The *Corporations Act 2001* contains provisions which roughly parallel the 'clawback' provisions of the *Bankruptcy Act 1966* and there are also provisions which allow for recovery of money from company officers in a range of circumstances. A prerequisite to the employment of these provisions is the liquidation of the company.

65. The compromise agreement should proceed on the assumption that the Commissioner has exercised his rights under the above provisions. The amount, if any, to be included in the determination of the position without compromise should be settled between the debtor and the Tax Office. No allowance should be made for the costs or delay involved in enforcing those remedies.

66. A compromise will generally deliver better results than would be obtained by any available recovery processes and for this reason many, perhaps most, debtors may be unwilling to reach a compromise settlement. As a consequence, the amounts ultimately recovered in some cases adopting other recovery approaches may be significantly less than the amounts calculated under this approach.

67. These losses, however, are seen to be simply a cost associated with achievement of the broader objective of voluntary compliance by the taxpaying community at large. From the perspective of the Tax Office, exercising good management and administrative commonsense in the general administration of the tax law entails giving precedence to this objective over the recovery of some additional funds in individual cases.

68. There are, of course, some circumstances in which it would be acceptable to discount the face value of rights relating to past transactions or anticipated future interests. Such cases would include those involving costs of litigation which is unrelated to any action on the part of the debtor that was detrimental to the interests of the Commonwealth as a creditor (for example, costs associated with an action for damages for personal injury or breach of contract by an arms-length party).

69. It would also be permissible to discount the value of a debt payable to the debtor in the future provided that the circumstances concerning its creation and terms of repayment do not involve uncommercial elements. An interest-free loan to a party associated with the debtor, for example, could be considered to be uncommercial in this sense.

70. It is important to ensure that non-compliant behaviour in the form of reckless or careless failure to make provision to pay an expected tax liability, even by instalments over time, is not rewarded or condoned. Again, the broader

objective of achieving voluntary compliance is more important than the amount recovered in any individual case.

Losses that may be available for tax purposes

71. It will not be unusual that a debtor who makes a compromise proposal has incurred substantial losses of either a revenue or a capital nature, or both. It would be quite unacceptable that a debtor be allowed the benefit of a compromise, whether in respect of an income tax debt or some other tax debt, but at the same time retain the right to offset losses against future income or capital gains.
72. Consequently, the deed evidencing the compromise should contain provisions which bind the debtor not to claim losses against income of future years and to exclude capital losses from the calculation of future net capital gains or losses. The provisions would need to clearly identify the losses to be foregone by reference to a date, usually the end of the financial year either preceding or succeeding the date of the deed.
73. In some cases, it might also be necessary for a debtor company to bind itself not to transfer such losses to another group company under subdivisions 170-A and 170-B of the ITAA 1997. Agreements of this kind, which effectively amount to abandonment of the debtor's statutory rights, can be validly entered into by debtors and would be enforceable by the Tax Office.
74. In cases where losses are to be foregone by a debtor, the necessary steps must be taken to ensure that such losses are not in fact allowed in future assessments.

Determining position with compromise

75. Having ascertained what the position would be without a compromise, it is then possible to assess what benefit will flow to the Commonwealth from acceptance of the compromise offer. Unless benefits of substance can be clearly demonstrated, then the compromise offer should be rejected.
76. It is not sufficient that the compromise offer is equal to the Tax Office's assessment of what the position would be without the compromise; there must be a positive advantage of substance to the revenue in accepting the compromise. If for no other reason, this stance is justified by the fact that a compromise will involve loss of access to any future windfall gains by the debtor which, of course, will not have been taken into account in the evaluation process described previously.

Deed to evidence compromise agreement

77. In ALL cases of compromise, a deed, which is to be drafted by the Tax Office's solicitor, is to be signed by all relevant parties to evidence what has been agreed between the parties. It would be appropriate to involve the Tax Office's solicitor at an early stage of discussions with the debtor.
78. As a general proposition, all of the material relied upon by the Tax Office in agreeing to a compromise or a schedule detailing that material should be annexed to the relevant deed which should contain appropriate warranties by the debtor concerning the accuracy and completeness of the material supplied.

79. Debtors should also warrant that they have not omitted to inform the Tax Office of any material matter which might be reasonably relevant to the Tax Office's decision to enter into the compromise.
80. The deed should be drawn to ensure that the Commissioner will not be bound by the covenant to refrain from exercising remedies for recovery if the debtor provides any incorrect or incomplete information or fails to disclose any material matter. That is to say, the Tax Office will consider a deed to be invalid and will terminate any agreement to compromise a debt and commence or continue action to recover the whole of the outstanding debt if it establishes that the information provided by the debtor, either directly or on his behalf and upon which the decision to compromise was based, was incomplete, false or misleading.
81. Quite apart from the consequences that flow from the terms of the deed, of course, the provision of incorrect or incomplete information might well involve offences under sections 8N of the TAA or Division 136 or Division 137 of the *Criminal Code Act 1995* (false or misleading statements). The debtor should be made aware of the implications of making false and misleading statements and this fact should be acknowledged by a term to be included in the deed.
82. There are a number of other matters which need to be appropriately provided for in the deed. The debtor will insist there is a provision that the Commissioner covenants not to pursue the balance of the tax debt from the debtor once the compromise amount is fully paid, provided there has been compliance with all other terms of the deed.
83. The Commissioner or his delegate and the debtor will be parties to any deed which evidences the terms of the compromise, but in some cases, others may need to be made parties as well. Alternatively, there may be a need in some cases to execute collateral agreements or deeds or securities with the other parties. These matters will be governed by the nature of the obligations imposed on, or assumed by, those parties under the terms of the compromise and to some extent, by the wishes of those parties.
84. A basic premise of a compromise is that there is no dispute as to the amount of the debtor's liability. Consistent with that position, the deed should contain an acknowledgment of indebtedness by the debtor and should bind the debtor not to exercise any right, whether arising under Part IVC of the TAA or otherwise, to dispute the amount or existence of that indebtedness.
85. Generally speaking, it would be inappropriate to ask a debtor to undertake not to seek release from liability to the compromised debt on the grounds of hardship in the future. This is because those matters which are relevant to consideration of a compromise offer do not include hardship considerations. For the purposes of any application for release made after a compromise has been entered into, the amount of tax owing is the amount payable under the compromise.
86. The fact that an application for release has been lodged will not excuse the debtor or other parties from performing all of their obligations under the terms of the compromise as and when required by the deed. Failure to carry out an obligation on time will attract the default provisions of the deed as if no release application was pending.
87. A compromise will not legally release a debtor from a debt until all the terms of the deed have been satisfied. A deed evidencing a compromise should clearly set out the consequences of default by the debtor or some other party to the

deed. The consequences for the various parties will, of course, vary depending upon their respective obligations under the deed.

88. As a general rule, any default by any party in any obligation should allow the Tax Office to exercise any or all of the remedies that it could have exercised against the debtor or his property or any other person if the compromise had not been entered into, for the purpose of recovering the whole amount of tax still owing, not just the (balance of the) compromised amount. Additional charges for late payment/GIC should be brought up to date. These consequences of default should be in addition to any other consequences such as the crystallisation of liability of guarantors or triggering the right to realise securities.
89. In some circumstances, it is possible that the Tax Office may be required under bankruptcy or company law or otherwise to give up the benefit of some or all of the money paid pursuant to a compromise in favour of creditors generally. The deed should normally treat such an event as a default in terms of the consequences which flow from it so that the Commissioner will be able to prove in the bankruptcy or liquidation for the whole of the tax still owing, not just the (balance of the) compromised amount.
90. Provision should also be made which allows any of the following events, at the option of the Tax Office, to be treated as a default during the currency of the deed:
 - (i) failure of the debtor or any other party to the deed to comply with any taxation obligations, including lodgment and payment, for a period of, say, three years after the date of signing the deed
 - (ii) the presentation of a bankruptcy petition against the debtor or any other party to the deed
 - (iii) the signing of an authority under section 188 of the *Bankruptcy Act 1966* by the debtor or any other party to the deed
 - (iv) the presentation of an application for the winding up of the debtor or any other party to the deed
 - (v) the calling of a meeting to consider the voluntary winding up of the debtor or any other party to the deed, or
 - (vi) the appointment of an administrator or a controller within the meaning of the *Corporations Act 2001* in relation to the debtor or any other party to the deed.

Proper recording of decisions

91. The nature of the decisions inherent in deciding to compromise a taxation debt is such that the decisions need to be fully documented.
92. It is unlikely that a decision to accept or reject an offer for compromise would be considered to be an administrative decision of a kind which is reviewable by a court under the *Administrative Decisions (Judicial Review) Act 1977*. Nevertheless, it is important that details of the decision-maker's findings on material questions of fact, including the evidence on which they were based and the reasons for the decision, are fully recorded so that such decisions can be explained and supported if necessary.

Writing off the balance of the debt

93. Once the Commissioner enters into a covenant not to exercise discretionary remedies, and so long as he remains bound by it, the portion of the debt which is to be forgone will be irrecoverable at law by the Commissioner and may not be pursued under section 47 of the *Financial Management and Accountability Act 1997*. However, that action will not be taken during the currency of the deed. That part the Commissioner has agreed not to pursue should be identified as a doubtful debt.
94. The terms of a compromise agreement may require the debtor to make payment by one lump sum or by two or more instalments over time. Until such time as all the terms of a deed have been fully satisfied, the Tax Office will continue to offset any credits that may arise against the amount of the tax debt. When a tax debt has been extinguished under a deed of compromise, any credits that may subsequently arise cannot be applied against the amount of debt that the Commissioner has agreed to compromise.

Application of payments

95. Any amounts received under a compromise agreement will be applied in the same manner as if the debtor had been declared bankrupt. Amounts received should be applied in the following order:
 - (i) amounts withheld prior to 1 July 1993 in respect to PAYE, prescribed payments, dividend or interest withholding taxes, or natural resource and royalty payments;
 - (ii) to any annual Superannuation Guarantee Charge (SGC) debts (that is, relating to periods before 1 July 2003), commencing with the debts that have the earliest due date, applying the payments in the following order:
 - the administration component
 - additional charges for the unpaid Part 7 of the *Superannuation Guarantee (Administration) Act 1992* penalty charges (late payment penalty)
 - additional charge for the unpaid Part 7 penalty charges (general interest charge)
 - Part 7 Penalty Charges
 - additional charges for the unpaid total of the individual superannuation guarantee shortfall (late payment penalty)
 - additional charge for the unpaid total of the individual superannuation guarantee shortfall (general interest charge)
 - the nominal interest component
 - the total of the individual superannuation guarantee shortfall.

The same order is to be followed in applying payments in each subsequent period until all outstanding annual SGC debts are finalised, and then:
 - (iii) to any quarterly SGC debt (that is, relating to periods from 1 July 2003), commencing with the debts that have the earliest due date, applying the payments in the following order:
 - the nominal interest component

- the total of the individual superannuation guarantee shortfall
- additional charges for the unpaid total of the individual superannuation guarantee shortfall (general interest charge)
- the administration component
- Part 7 penalty charges
- additional charges for the unpaid Part 7 penalty charges (general interest charge).

The same order is to be followed in applying payments in each subsequent period until all outstanding quarterly SGC debts are finalised.

- (iv) all other debts.

TERMS USED

Compromise – in this context means to permanently agree not to pursue recovery of the balance of a debt (effectively, to accept a sum less than the debt in full satisfaction of that debt - whether payable in one amount, either immediately or at a later date, or by instalments). It does not refer to agreements involving full payment, at a later date or by instalments, authorised by various taxation enactments which are discussed in detail elsewhere in this policy. Guidelines for the settlement of disputed taxation liabilities are contained within the Tax Office 'Code of Settlement Practice.'

Chapter 27 - Archived version

Version 4 – July 2006 (will link to chapter 27 pdf)
