# *PS LA 2011/7 - Settlement of debt recovery litigation*

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# Practice Statement Law Administration

# PS LA 2011/7

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*This practice statement is issued under the authority of the Commissioner of Taxation and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by tax officers unless doing so creates unintended consequences or where it is considered incorrect. Where this occurs tax officers must follow their business line's escalation process.*

**SUBJECT: Settlement of debt recovery litigation**

**PURPOSE: To outline the risk factors to be considered in bringing debt recovery litigation to an end by settlement**

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## BACKGROUND

1. The timely collection of taxation debts is predicated on an evaluation of risk to payment of these liabilities after they fall due.
2. Law Administration Practice Statement PS LA 2011/6 outlines the ATO risk management principles, detailed in Corporate Management Practice Statement PS CM 2003/02 Risk and issues management, as they apply to the collection of unpaid liabilities, having regard to the compliance model.
3. The compliance model reflects the different taxpayer attitudes to compliance and the corresponding compliance strategy that best responds to each particular attitude.
4. The level of risk in each case is assessed by applying that policy, at the commencement of collection activities. In appropriate cases, the level of risk will warrant the commencement of litigation for recovery of an unpaid tax liability.
5. Once litigation for recovery has been initiated by or on behalf of the Commissioner, the risk assessment process continues throughout the litigation proceedings.
6. Where the relevant risk factors remain unchanged throughout the course of the litigation, the Commissioner would generally pursue litigation to judgment and execution. However, at any time during litigation proceedings, additional facts may emerge or the debtor may advance submissions for settlement, which show upon reassessment of the risks involved that the level of risk warrants bringing litigation to an end.

## TERMS USED

7. The following terms are used in this practice statement:

   ***Settlement*** – means deciding not to commence litigation on consideration of relevant risk factors or ending litigation early due to new risk factors that have emerged after commencement of litigation or to the non identification of relevant risk factors prior to the commencement of the litigation.

   ***Legal Services Directions 2005*** – the directions which the Attorney-General has issued under section 55ZF of the *Judiciary Act 1903*, providing guidance to agencies on a number of issues, including:

   - Tied Areas of Commonwealth Legal Work
   - The Commonwealth's Obligation to Act as a Model Litigant
   - Handling Monetary Claims
   - The Engagement of Counsel, and
   - Assistance to Employees for Legal Proceedings.

The Legal Services Directions 2005 are legally binding on the agencies to which they apply, including the ATO. The Directions help to ensure that Commonwealth agencies receive consistent and well coordinated legal services that are of a high standard, that uphold the public interest and that are sensitive to their context of Commonwealth interests which are broader than any one agency.

A link to the Legal Services Directions 2005 and information about the Directions is provided in the Other References section at the end of this document.

***Model litigant guidelines*** – refers to guidelines issued by the Attorney-General requiring that the Commonwealth and it's agencies behave as model litigant in the conduct of their litigation. This requirement is set out in Appendix B to the Legal Services Directions 2005. In essence, being a model litigant requires that the Commonwealth or one of it's agencies, as a party to litigation, acts with propriety, fairness and in accordance with the highest professional standards. The obligation applies to the handling of civil claims and litigation before the Courts, Tribunals and Inquiries and in Alternative Dispute Resolution processes. The model litigant guidelines require Commonwealth litigants to handle their cases efficiently and effectively in accordance with their responsibility to the community to deal responsibly with public revenue and also to fulfil their responsibilities to other litigants and the justice system.

***Privative clauses -*** in the context of this practice statement means statutory provisions which purport to remove the ability of a court to review a decision of the Commissioner

***Undisputed primary tax debt -*** refers to a debt which is not the subject of an objection, review or appeal under Part IVC of the *Taxation Administration Act 1953* (TAA).

***Unpaid tax liability*** – includes reparation orders, legal costs and other liabilities that are payable to the Commissioner on behalf of the Commonwealth.

## SCOPE

8. This practice statement should be read in conjunction with the ATO's Code of Settlement Practice (Code).

9. The Code sets out the ATO's official guidelines on the settlement of taxation disputes about the correctness of taxation liabilities and entitlements assessed by the Commissioner. It provides guidance as to the situations in which settlement of such disputes could be considered and outlines the processes which should be followed.

10. The Code is primarily aimed at settlement of disputes that arise under Part IVC of the TAA. Debt recovery litigation has been expressly excluded from the scope of the Code because the Code concerns resolving what the correct liabilities and entitlements of a taxpayer are, while debt recovery litigation concerns the recovery of debts due to the Commonwealth in relation to taxation and other liabilities and entitlements for which the Commissioner has responsibility under the various legislation that he administers.

11. Notwithstanding this, the aim of this practice statement is to apply similar principles and philosophies to those of the Code to debt recovery litigation.

## STATEMENT

12. Law Administration Practice Statement PS LA 2009/9 Conduct of Tax Office litigation outlines the policies and guidelines to be followed in the conduct of ATO litigation As acknowledged therein:

> The Tax Office strives to have all disputes brought to finality in a fair, timely and equitable manner consistent with the law. The Tax Office supports the appropriate use of alternative dispute resolution techniques to limit the need for litigation and to simplify and/or reduce the cost of litigation.

13. Settlement is widely recognised as an effective means of resolving issues in dispute in certain cases, with the focus on controlling unnecessary costs while achieving a swift and satisfactory resolution for all parties without the need for protracted litigation.

14. In the context of debt recovery litigation, this practice statement mandates a careful examination of the potential risks involved in reaching a settlement.

### Types of debt recovery disputes

15. Disputes arising out of debt litigation may be classified into four broad categories.

16. The first category consists of those cases where the subject matter of the dispute could potentially give rise to an arguable defence by the defendant by virtue of the existence of a statutory defence regime. Such cases would include the following:

- director penalty matters (relating to penalties incurred by directors of non-complying companies under Division 269 of Schedule 1 to the TAA (and Division 9 of Part VI of the *Income Tax Assessment Act 1936* (ITAA 1936) for penalties due prior to 1 July 2010);
- actions commenced by liquidators against the Commissioner in relation to unfair preferences or other voidable transactions; and
- cases where the Commissioner seeks indemnity from a company director pursuant to section 588FGA of the *Corporations Act 2001.*

17. Cases in the second category are high risk cases where the Commissioner is pursuing the recovery of a debt notwithstanding the fact that it is the subject of a dispute under Part IVC of the TAA.

18. The third category consists of those cases where a bona fide defence by the defendant may exist based on the particular facts of the case; for example where, in a pay as you go (PAYG) matter, the defendant argues that he/she was not an employer for the purposes of the law or where the defendant argues that he/she was not a partner at the relevant time and therefore not liable for a partnership debt.

19. The fourth category includes all other cases where there is essentially no scope for the defendant to sustain a bona fide defence or where the defence could be frivolous having regard to the *privative clauses* afforded by the taxation laws (for example, section 177 of the ITAA 1936).

20. In addition, cases involving applications by taxpayers to set aside a judgment or a statutory demand may on the merit of the particular case fall into either the third or fourth category.

**What constitutes a settlement?**

21. According to the Code:[1]

> A settlement involves an agreement or arrangement between parties to finalise their matters in dispute in situations where it is in the best interests of the Commonwealth to do so. In the case of taxation disputes, special considerations arise because on one hand, the Commissioner's basic duty is to administer taxation law through assessing and collecting taxes and determining entitlements. However, the Commissioner also has an obligation to administer the taxation system in an efficient and effective way. Settlements usually involve the need to balance competing considerations, and call for the application of discretion and good sense.

22. At their broadest, the terms 'settlement' or 'compromise'[2] are used interchangeably in the context of litigation to mean the resolution of a particular claim or dispute. In essence, resolving a dispute in the debt recovery context usually means bringing the legal proceedings to an end by agreement of the parties.

23. Following settlement, the legal proceedings may be discontinued or the parties may enter into a Deed reflecting 'Terms of Settlement' to enforce the settlement.

24. Many aspects of the ATO's policy on the resolution of disputed matters that arise in litigation are already well documented in other practice statements, for instance:

    (a) accepting a payment arrangement by instalments which results in proceedings being discontinued or stayed (Law Administration Practice Statement PS LA 2011/14 General debt collection powers and principles)

    (b) remitting general interest charge (GIC) to finalise litigation (Law Administration Practice Statement PS LA 2011/12 Administration of general interest charge (GIC) imposed for late payment or under estimation of liability)

    (c) waiving the debt under either the *Financial Management and Accountability Act 1997* (FMA Act) or Division 342 of Schedule 1 to the TAA or alternatively released under the release provisions (Law Administration Practice Statements PS LA 2011/17 Debt relief and PS LA 2011/10 Waiver of taxation debts in proceeds of crime matters)

    (d) discontinuing litigation where new evidence adduced during the proceedings establishes that the debt sought to be recovered is irrecoverable at law (PS LA 2011/17)

    (e) discontinuing where the debtor's circumstances change during the proceedings and it becomes apparent that the debt sought to be recovered is uneconomical to pursue (PS LA 2011/17).

[1] At paragraph 2.

[2] Note that in the tax debt recovery context, 'compromise' has a different meaning, as explained in Law Administration Practice Statement PS LA 2011/3 Compromise of taxation debts and in paragraphs 27 to 29 of this practice statement.

25. As noted earlier, the risk assessment process starts at the onset of litigation and continues right through to finalisation of the case. At any time during litigation proceedings, additional facts may emerge or the debtor may advance submissions for settlement, which show upon reassessment of the risks involved, that the level of risk warrants bringing litigation to an end. Accordingly, for the purposes of these guidelines the discussion of '*settlement'* is limited to deciding not to commence litigation on consideration of relevant risk factors or ending litigation early due to new or additional risk factors that have emerged after the commencement of litigation.

## Compromise

26. Generally, settlement in debt recovery litigation may require the Commissioner to accept a lesser amount than the total value of his claim.

27. PS LA 2011/3 Compromise of taxation debts, deals with the compromise of taxation debts. 'Compromise' in this context means to accept a sum less than payment in full of any *undisputed* primary tax debt. The principles in PS LA 2011/3 apply to ***all*** such decisions and remain relevant in considering an offer that may arise in debt recovery litigation, where a bona fide defence is not available.

28. It is recognised that the prescriptive processes and procedures outlined in PS LA 2011/3, (which require the debtor to make a detailed formal written request for compromise) may not be sustainable in the context of debt recovery litigation where rigid time frames need to be observed. Nevertheless, in view of the fact that the Commissioner's power to compromise a taxation debt has only been delegated to a few Senior Executive Service (SES) officers, a recommendation to accept a compromise offer would ordinarily necessitate adjournment of the proceedings to enable escalation of the offer to the appropriate authorised officer. However, in certain circumstances where sufficient information is available which clearly indicates that a compromise offer should not be accepted, a decision to decline the offer can be made by the Commissioner's representative in the proceedings.

29. PS LA 2011/3 applies specifically to the compromise of '*taxation debts*'. Accordingly, actions commenced by a liquidator against the Commissioner in relation to an unfair preference or other voidable transaction are outside the scope of PS LA 2011/3.

## Legal basis for settlement

30. The Code sets out in detail the legal basis for settlement. It is now well accepted that the Commissioner's powers of general administration are wide enough to encompass settlement of any matters on principles which reflect good management of the tax system, overall fairness and best use of ATO resources ('the good management rule').

31. In the context of debt litigation, the Commissioner is equally empowered to enter into settlements which reflect the good management rule.

32. Tax officers must follow the principles and guidelines outlined in this practice statement when exercising the Commissioner's powers of general administration. It is noted however that it is not possible to set out all the circumstances in which the powers may or may not be exercised. Each case has to be considered on its merits and on the basis of all the relevant facts. Tax officers must exercise their own judgment in arriving at an appropriate decision. The decision should be made in good faith and without bias.

## Authority to settle

33. Traditionally debt recovery proceedings were conducted primarily in the State or Territory Courts. However in recent times, a number of debt recovery matters are also being conducted in the Federal Court as well as the Federal Magistrates Courts. Each of these Courts has different case management requirements including varying degrees of court mandated and/or supervised alternative dispute resolution (ADR). Many of the defended debt recovery proceedings each year are subject to court ordered ADR, ranging from informal case conferences to formal mediations.

34. In addition most of the unfair preference and indemnity proceedings against directors to which the Commissioner is made a party each year are appropriate to be subject to ADR.

35. The Commissioner had previously delegated his power to settle debt recovery litigation to a limited number of SES officers. Given the growing volume of defended debt litigation matters and the Courts' apparent desire to reduce their case lists through ADR processes such as mediation, the growing demand for ATO case officers to be authorised to participate in ADRs has led to further delegation of the Commissioner's power to settle debt recovery litigations to Litigators in the Legal Services Branch. Such authority also extends to the settlement of pre-litigation matters, in appropriate cases, where the purpose of settling is to avert litigation and the costs associated therewith.

## Alternative dispute resolution

36. PS LA 2009/9 recognises the importance of ADR as follows:[3]

> The model litigant obligation imposes a positive and ongoing obligation on officers involved in the conduct of litigation on behalf of the Commonwealth and its agencies to consider the use of ADR 'to avoid, prevent and limit the scope of legal proceedings wherever possible, including giving consideration in all cases to ADR before initiating legal proceedings and by participating in ADR processes where appropriate'. …
>
> The Tax Office recognises and supports the use of ADR as a cost effective, informal, consensual and speedy means of resolving disputes. This extends to using ADR to deal with only part of a dispute, or to deal with procedural or interlocutory matters in relation to a dispute. All tax officers handling disputes are required to consider whether the use of ADR, which includes direct engagement and negotiation with taxpayers, would be an appropriate means which might assist in the resolution of the dispute or might limit the scope of the dispute in some material way.

37. Depending on the circumstances, there is a range of alternative dispute resolution approaches, including mediation, which could be used to assist in reaching settlement. The ATO ADR homepage is designed as an internal access point for ADR information including policies, procedures, support materials and useful external links. A link to this homepage is included in the Other References section at the conclusion of this practice statement.

38. A full discussion of the policies and guidelines that tax officers must follow when attempting to resolve or limit disputes by means of ADR is set out in Law Administration Practice Statement PS LA 2007/23 Alternative Dispute Resolution in Tax Office disputes and litigation.

[3] At paragraphs 21 to 22.

39. Prior to attending an ADR in respect of debt recovery litigation, the Commissioner's representative will notify all parties, including the mediator/ facilitator, of the Commissioner's policies which apply to an ADR of the matter, including any limitations on settlement of the particular matter.

**Risk management in litigation**

40. PS LA 2009/9 outlines the ATO's approach to risk management in litigation. In line with the established ATO risk matrices, it provides a framework for the identification and rating of the various types of risks to business outcomes that arise from the conduct of litigation and prescribes the requisite risk treatments through processes and structures that are directed towards the effective management of potential opportunities and adverse consequences that might arise from litigation.

41. Annexure G of PS LA 2009/9 explains[4] that risk assessment in debt cases is covered by Law Administration Practice Statement PS LA 2011/6 Risk and risk management in the ATO. If the taxpayer files a defence, the litigation risk needs to be reassessed. In significant debt matters this occurs through the debt litigation call-over process, which would include consideration as to whether Tax Counsel should be involved in the matter.

42. Given the high volume and factual nature of litigation arising in debt matters, the call-over process is usually limited to the more complex defended matters that are not suitable for summary proceedings or where the defendant has been granted leave to defend the proceedings. Notwithstanding this, once any matter is in litigation, the litigation team (usually the Legal Services Branch (LSB) officer in conjunction with the LSB Manager and the Debt case officer) must undertake its own risk assessment (separate from the call-over and Priority Technical Issue process) to determine the level of the litigation risk associated with the case. This will assist the team to determine and apply the most appropriate litigation strategy.

43. Risk assessment is not optional and must be carried out in every case. This reflects the wider requirement that risk management underpins all ATO activities (PS CM 2003/02). Litigation arising in debt matters is of high volume and often relates only to a factual dispute limited in its application to the circumstances of the particular taxpayer; this may substantially limit the revenue risk associated with such debt litigation. Annexure G to PS LA 2009/9 explains accordingly:[5]

> All litigation carries with it a risk of monetary loss. In Tax Office litigation, the revenue at risk may depend in part upon whether the dispute is factual and therefore limited in its application to the circumstances of the particular taxpayer, or whether it may have wider revenue consequences in terms of legal principle that may have widespread effect.
>
> Revenue risks in litigation can be monitored at the organisational level of total disputed debt or total tax in dispute in tax technical litigation. Overall trends in these areas may be indicative of systemic changes in taxpayer behaviour, or changes in Tax Office administrative practices. Revenue risks are usually monitored at the individual case level or at the issue level, where groups of cases carry like issues. The level of revenue at risk in a particular case may highlight a reason to escalate the matter for TCN involvement. Where the amount in dispute is small, it may suggest that careful consideration should be given to whether the case is suitable for settlement.

[4] At paragraph 8.
[5] At paragraphs 20 to 22.

The business line case officer is responsible for determining the revenue risk for the case or issue. This occurs as part of the SILC (Strategic Internal Litigation Committee) or call-over process.

44. Strict conformance with the processes outlined in PS LA 2009/9 is mandatory.

**Risk based principles**

45. As prescribed in PS LA 2009/9, litigation should be risk assessed using the Litigation Risk Matrix. General considerations in the risk assessment process which may be relevant to the decision to commence, continue and/or settle debt recovery litigation (including preference/indemnity proceedings) may include:

    (a) the overall good management of the ATO

    (b) the application of the compliance model

    (c) the best use of agency resources (for instance, section 44 of the FMA Act)

    (d) the application of the Attorney-General's Legal Services Directions 2005 (and in particular the Model Litigant guidelines)

    (e) changes in the risk assessment of the litigation

    (f) whether the litigation is suitable as a test case for a wider principle or issue; this may include law clarification or identifying the need for legislative reform.

46. The ongoing consideration of the factors set out above in the risk assessment process may at any stage of the litigation result in a conclusion being reached that, in the circumstances as now known or understood, litigation ought now be settled.

47. Accordingly, these settlement principles apply to situations where there has been a change to the risks associated with the subject case. That change may include:

    - factors that were overlooked in the initial risk assessment prior to litigation commencing, and/or
    - new factors that have emerged after commencement of litigation.

48. In assessing potential changes to the risks associated with a subject case, due consideration must be given to the recognised risks to business outcomes from the conduct of litigation as enunciated in Annexure G to PS LA 2009/9. Those risks include:

    - Legal risk
    - Revenue risk
    - Operational risk
    - Compliance risk, and
    - Reputational risk.

49. As a general rule, in evaluating the level of litigation risk in the face of a settlement offer, the comparison of the cost of litigation to the likely return to the revenue should not on its own be the determining factor in deciding whether or not to accept a settlement. However, whilst a single risk factor may not, on its own, warrant consideration of a settlement, the weight of a combination of any of the risk factors may justify settlement.

### *Legal risk*

50. Annexure G of PS LA 2009/9[6] states that 'legal risk'

> refers to risks arising from the uncertainty in the interpretation of legislation administered by the Commissioner, and in a commercial sense uncertainty or ambiguity in contracts entered into. Legal risks also include the specific risks that flow from the litigation process itself, including risks of breaching court and tribunal orders, breaching or being perceived to breach the Attorney-General's Legal Services directions, adverse comment from the courts and tribunals as well as the risk of increased litigation. The exposure arising from legal risks range from one-off decisions with minor consequences to substantial consequences for the law and Commonwealth revenue.

51. This type of risk is prominent in cases where evidence disclosed during litigation establishes that the defendant may have an arguable defence against the claim which is the subject of the proceedings.

52. Legal risk will be the primary and often determining factor for most cases considered appropriate for settlement.

53. The level of risk will vary in degrees across a broad spectrum of cases between those that have an arguable defence with very little prospect of success through to those that are highly (although not conclusively) likely to succeed. For example, this type of risk could be present in a director penalty case where the evidence adduced does not conclusively meet the statutory defence but could influence the Court to give judgment against the Commissioner. In this type of case, it may make good sense to settle the case based on the prospect of success as advised by our solicitors and/or counsel.

### *Revenue risk*

54. Annexure G of PS LA 2009/9[7] states:

> all litigation carries with it a risk of monetary loss. In ATO litigation, the revenue at risk may depend in part upon whether the dispute is factual and therefore limited in its application to the circumstances of the particular taxpayer or litigant, or whether it may have wider revenue consequences in terms of legal principle that may have widespread effect.

55. This type of risk may arise in a case where a novel or arguable defence has the potential to affect well-settled ATO processes or where the Commissioner's position on a particular matter has not yet been settled. An adverse decision on such a case could impact on many others and affect the ATO's ability to deliver our projected collection targets. Such risks would need to be carefully managed, and in certain circumstances, may result in a decision to continue litigation in the pursuit of judicial clarity to justify legislative intent or highlight the need for legislative amendment. Conversely, the existence of other risk factors may warrant settlement of the matter on its merits.

[6] At paragraph 15.
[7] At paragraph 20.

### *Operational risk*

56. Annexure G of PS LA 2009/9[8] states:

> Operational risks have been described as 'the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events'
>
> The risks to be identified under this heading are diverse, including the capability and availability of the individuals involved in the litigation team to carry out their duties competently, and the capabilities of internal and external systems to support the litigation in unusual and unforseen circumstances. Operational risks can be as obscure as bad weather stopping a key witness from attending court.

### *Compliance risk*

57. Annexure G of PS LA 2009/9 states:[9]

> Compliance risk is an acknowledgment that a number of key factors can influence taxpayer behaviour in complying with the law. It is the current and prospective risk to revenue arising from community non-conformance with laws, regulations, precedential ATO views (such as public rulings), or standards of conduct normally expected of the community. Compliance risk also arises in situations where the law or ATO view expressed in precedential products may be ambiguous or untested. In this sense compliance risk is closely aligned with legal risk. The risk exposes the Commonwealth to loss of revenue. A case in litigation that potentially exposes a defect in tax law can have widespread consequences for compliance by the community and confidence in the system.

### *Reputational risk*

58. Annexure G of PS LA 2009/9 states:[10]

> Reputational risk refers to the negative experiences or perceptions that may arise during or as a result of litigation that may affect the ATO's standing with government, the judiciary, other departments, our external advisers, or the community.

59. The decision as to whether or not to settle can, in certain circumstances, carry a reputational risk where the community perception is that the ATO is being 'too hard' or 'too soft' on certain taxpayers or market segments. Similarly there are reputational risks if settlements are not seen to be applied consistently.

60. Community confidence in the ATO could also be jeopardised by perceptions of prejudice and disadvantage to those taxpayers who meet their payment obligations by the due date, if the Commissioner were to settle litigation with taxpayers who have not engaged with the ATO to meet their obligations.

61. To settle in such circumstances would undermine the ATO compliance model and could expose the ATO to the reputational risk of failing to meet its statutory obligations. Such risk has the potential to diminish community confidence and impact on the reputation of the ATO.

[8] At paragraphs 27-28.
[9] At paragraph 30.
[10] At paragraph 31.

**Commercial settlement**

62. During litigation, the defendant may offer payment of an amount which exceeds the net value of their assets or an amount that exceeds the net maximum return after accounting for an estimate of the Commissioner's costs of continuing the litigation.

63. This type of settlement offer is often referred to as a 'commercial settlement', where the proposed return is aimed at minimising exposure to the costs associated with the continuation of litigation and returning an amount greater than would ultimately be collected at the conclusion of litigation.

64. PS LA 2011/3, discusses commercial settlements and conveys the principle that 'the Commissioner will not accept compromise proposals unless there is a benefit in doing so over and above the returns that would flow from taking either bankruptcy or corporate insolvency actions'. This practice statement provides that the Commissioner will not take into account the additional costs of litigation which are caused by the debtor failing to engage with the Commissioner earlier. Only the reasonable future costs of litigation and asset realisation can be taken into account.

65. As a general rule, a 'commercial settlement' will only be accepted in limited circumstances, as a personal insolvency agreement or debt agreement under the *Bankruptcy Act 1966* or in the case of a corporate insolvency, a voluntary administration under Part 5.3A of the *Corporations Act 2001*. Such processes are considered to be more appropriate in terms of fairness to all creditors and also for certainty in terms of disclosure about asset holdings.

66. Notwithstanding this, a settlement may be warranted in circumstances where in addition to the commercial aspect of the offer, there are other risk factors present that warrant settlement.

**When settlement discussions may occur**

67. In debt recovery litigation, settlement discussions between the Commissioner and taxpayers will generally take place after commencement of the proceedings, usually after lodgment of a defence. However, in certain circumstances, taxpayers may wish to minimise their legal costs by making settlement overtures prior to formally lodging a defence.

68. In cases involving voidable transactions, a liquidator may commence negotiations for settlement immediately after serving the Commissioner with a letter of demand which provides sufficient evidence of the claim but prior to the issue of legal proceedings under section 588FF of the *Corporations Act 2001*.

69. After receiving a settlement offer, the Legal Services Branch Litigator or External Legal Service Provider will confer with the Debt case officer to determine whether there has been any change to the risks assessed prior to the commencement of litigation that warrants bringing litigation to an end by settlement.

70. Similarly, in other matters where legal proceedings are imminent but have not yet been commenced by the ATO, such as director penalty matters, representations to settle the matter may be received with the view to avert litigation. The guidelines set out in this practice statement will generally apply where a case lends itself to settlement upon assessment of litigation risks. However, where it is proposed to accept an offer for a lesser sum than the full amount of the primary tax, based on considerations other than litigation risks, the matter should be dealt with in accordance with the compromise guidelines set out in PS LA 2011/3.

71. In a number of circumstances, particularly in cases where a bona fide defence may not be available, although the risks assessed may remain unchanged, taxpayers may wish to end litigation by entering into a repayment arrangement or negotiating a compromise. Settlement in those circumstances may well be acceptable having regard to the guidelines set out in other law administration practice statements.

72. In cases involving litigation for recovery of debts which are the subject of a dispute under Part IVC of the TAA, settlement may also be appropriate subject to the mitigation of the risks originally assessed with regards to the considerations laid out in the Code and in Law Administration Practice Statement PS LA 2011/4 Recovering disputed debts. Consultation with the case officer dealing with the Part IVC dispute would be paramount in considering any offer of settlement.

**Circumstances where it may be generally appropriate to settle**

73. As a general guide, settlement may be an appropriate way to resolve a matter if:

- there is doubt about the Commissioner's ability to overcome the taxpayer's defence and the costs and time delay associated with collecting the full amount of the debt are such that the real value of the proposed settlement offer is in excess of the amount that is likely to be collected some time in the future
- scope exists for the matter to be resolved swiftly through alternative dispute resolution without expending further costs in continuing to defend or pursue a claim
- there is insufficient evidence available (for example, through the passage of time) to support the Commissioner's ability to successfully recover funds held by entities other than the taxpayer
- pursuing a matter to trial could prejudice well-established principles of law.

74. Where fresh evidence which comes to light during the proceedings clearly establishes and supports the taxpayer's defence, the Commissioner, as a model litigant, would be required to discontinue litigation.

**Circumstances where it would be generally inappropriate to settle**

75. As a general guide, it would be inappropriate to settle in circumstances where:[11]

- the outcome of the settlement would be contrary to an articulated policy reflected in the law
- the matter is subject to a PTI and litigation is considered desirable to settle the ATO view
- inability to pay the tax debt has been deliberately contrived through the dissipation of assets to third parties
- the taxpayer's defence is poor and unlikely to be pursued through to trial. Care is necessary to ensure the settlement practice does not encourage frivolous defences

[11] Paragraph 25 of the Code of Settlement Practice.

- it is in the public interest to have judicial clarification of the issue and the case is suitable for this purpose – in certain cases, it may be appropriate to fund the litigation under the test case litigation program.[12]
- the matter is clear-cut or there is a clearly established and articulated ATO view on the issue or precedential authority in favour of the Commissioner already exist
- the settlement would involve inconsistency of treatment for taxpayers in comparable circumstances, or
- litigation of the matter through the courts could have a significant flow-on compliance effect and the case is suitable for this purpose.

### Remission of GIC

76. The ATO policy governing the remission of GIC is set out in PS LA 2011/12. Administration of general interest charge (GIC) imposed for late payment or under estimation of liability is not to be used as an inducement to settle a disputed debt, though, in certain circumstances, remission of GIC may form a component of a settlement.

### Settlements and prosecutions

77. Care needs to be exercised in considering settlement offers in debt recovery litigation where the debtor is the subject of a prosecution or is in the process of being charged with criminal offences.

78. Guidelines and procedures for referring cases to the Serious Non-Compliance (SNC) business line can be found in Corporate Management Practice Statement PS CM 2007/02 Fraud Control and the Prosecution Process. If a case falls within the guidelines, tax officers should seek a formal written response from SNC on the impact of a settlement on a potential prosecution before entering into any settlement negotiations. In providing the written response, SNC will normally seek advice from the Commonwealth Director of Public Prosecutions (CDPP) on the issue.

79. Officers should also formally advise SNC if there are indications that criminal offences may have been committed by the taxpayer and/or another party. SNC will then provide advice, including what action, if any, that SNC may take.

80. SNC will consider the question of prosecution or other responses including, if appropriate, the referral of the matter to the CDPP in respect of criminal prosecutions in accordance with PS CM 2007/02.

81. Where a matter has been referred to SNC or the Australian Federal Police, officers must formally advise SNC of any proposed settlement before taking any action which might prejudice any investigation.

[12] Under the test case litigation program, the ATO provides financial assistance to taxpayers whose litigation 'is likely to be important to the administration of Australia's revenue and superannuation system'. The criteria for applying for test case funding is available on www.ato.gov.au.

### No prosecution exemption

82. Tax officers do not have authority to make it a condition of a settlement that a taxpayer or another person will not be prosecuted, or that proceedings associated with a prosecution will not be taken either by the ATO or another agency. Accordingly, a clause or condition that purports to exempt a taxpayer or another party from prosecution, or associated proceedings, cannot form part of any ATO settlement agreement and is not enforceable.

83. Equally, it is ATO policy that officers must never use the threat of prosecution, either actual or implied, as a lever to settle cases.

### Procedures

84. To ensure transparency, consistency and accountability, strict compliance with Legal Services Branch procedures for settlement is mandatory.

85. For staff development and quality assurance as well as corporate governance purposes, settlements accepted by the ATO may be subject to selection for the integrated quality framework process which will be conducted jointly by senior officers of the Debt business line and Legal Services Branch.

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| Legislative references | ITAA 1936 177<br>TAA 1953 Pt IVC<br>TAA 1953 Sch 1 Div 269<br>Bankruptcy Act 1966 Pt IX<br>Bankruptcy Act 1966 Pt X<br>Corporations Act 2001 588FGA<br>Corporations Act 2001 588FF<br>Corporations Act 2001 Pt 5.3A<br>FMAA 1997 44<br>Judiciary Act 1903 55ZF |
| Related practice statements | PS CM 2003/02 Risk and issues management (internal link only)<br>PS CM 2007/02 Fraud control and the prosecution process (internal link only)<br>PS LA 2007/23 Alternative Dispute Resolution in Tax Office disputes and litigation<br>PS LA 2009/9 Conduct of Tax Office litigation<br>PS LA 2011/3 Compromise of taxation debts<br>PS LA 2011/4 Recovering disputed debts<br>PS LA 2011/6 Risk and risk management in the ATO<br>PS LA 2011/10 Waiver of taxation debts in proceeds of crime matters<br>PS LA 2011/12 Administration of general interest charge (GIC) imposed for late payment or under estimation of liability<br>PS LA 2011/14 General debt collection powers and principles<br>PS LA 2011/17 Debt relief |
| Other references | ATO's Code of Settlement Practice<br>ADR Home Page (internal link only)<br>Legal Services Directions 2005 |
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