PS LA 2011/7 - Settlement of debt litigation proceedings

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PS LA 2011/7
Settlement of debt litigation proceedings

This Law Administration Practice Statement outlines the risk factors to be considered in settling debt litigation proceedings.

This practice statement is an internal ATO document, and is an instruction to ATO staff.

Taxpayers can rely on this practice statement to provide them with protection from interest and penalties in the following way. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty. Nor will they have to pay interest on the underpayment provided they reasonably relied on this practice statement in good faith. However, even if they don't have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

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1. What this practice statement is about

This practice statement sets out our approach to settling debt litigation proceedings.

2. Summary

Settlement can be a cost effective way to quickly resolve litigation (and pre-litigation) disputes. Settling debt litigation matters requires you to assess the various risks involved in reaching a settlement, which are detailed below.

Considering whether settlement is appropriate is important in complying with model litigant obligations. These obligations require Commonwealth litigants to handle their cases efficiently and effectively, in accordance with their responsibility to the community to deal responsibly with public revenue.

This practice statement is to be read alongside the *Code of settlement practice* (Code). Whilst the Code applies to settling disputes arising under Part IVC of the *Taxation Administration Act 1953*, its principles can extend to debt litigation proceedings.

3. What is a settlement?

A settlement is an agreement or arrangement between parties to finalise their matters **in dispute**. Settlements involve the balancing of the Commissioner's duties to administer the tax law by assessing and collecting taxes, and administering the tax system in a fair, efficient and effective way.

Settlement, for the purposes of this practice statement, is limited to deciding not to commence litigation proceedings on consideration of relevant risk factors, or ending the litigation proceedings early due to new or additional risk factors that have emerged after the commencement of the litigation proceedings.

Legal basis for settlement

The Commissioner's powers of general administration encompass settlement of any matters on principles that reflect good management of the tax and superannuation systems, overall fairness and best use of our resources. This is commonly known as the 'good management rule'.

Application of ATO policy to settlements

Our existing policies may assist in settling debt litigation proceedings. For instance:

- accepting a payment arrangement by instalments, including any security, that results in a proceeding being discontinued or stayed (Law Administration Practice Statement PS LA 2011/14 *General debt collection powers and principles*)
- remitting general interest charge (Law Administration Practice Statement PS LA 2011/12 *Remission of General Interest Charge*)
- discontinuing litigation proceedings to allow the taxpayer to apply to the Department of Finance and Deregulation or the Minister for a waiver of their debt, or apply to us for release from their debt in cases of serious hardship (Law Administration Practice Statement PS LA 2011/17 *Debt relief, waiver and write off*), or
- discontinuing litigation where information establishes the debt is either irrecoverable at law or uneconomical to pursue (PS LA 2011/17).

Settlement versus compromise

To 'compromise' is to accept a sum less than payment of the full **undisputed** primary tax debt. A settlement is an agreement or arrangement between parties to finalise their matters **in dispute***.*

Law Administration Practice Statement PS LA 2011/3 *Compromise of undisputed tax-related liabilities and other amounts payable to the Commissioner* applies in considering offers to compromise undisputed tax debts and conveys the principle that compromise will only be considered in very limited circumstances.

Commercial settlement

A 'commercial' settlement is a settlement that reflects commercial practice between a commercial creditor and a commercial debtor. In a debt litigation context, this means a settlement where we would receive less than the full debt, but more than he would in bankruptcy or liquidation.

The Commissioner is not a commercial creditor, and must approach settlement in accordance with the principles in this practice statement. We should not settle solely on a commercial basis. Settlements must account for fairness to other creditors and taxpayers who pay their debts as they fall due.

With the exception of insolvency litigation matters, a commercial settlement offer is better considered as a compromise request under PS LA 2011/3. For guidance on insolvency litigation matters, refer to Law Administration Practice Statement PS LA 2011/16 *Insolvency – collection, recovery and enforcement issues for entities under external administration.*

4. Risk-based approach

We must undertake a risk assessment in determining whether or not it is appropriate to settle a debt litigation proceeding. This assessment must take place both when commencing and throughout a debt litigation proceeding.

Broad risk categories include:

- legal risk
- revenue risk
- reputational risk
- compliance risk
- operational risk.

Legal risk

Legal risk is the risk we face in proceeding with a claim. This risk can arise from:

- the uncertainty in the interpretation and/or application of the law
- the uncertainty or ambiguity in any contract entered into
- risks flowing from the litigation itself, such as adverse court findings and the risk of increased litigation
- not settling a matter which may have precedential value or highlight the need for legislative reform.

Legal risk is the primary and often determining factor for most cases considered appropriate for settlement.

Legal risk is often dependent on evidence. The level of risk can change throughout a litigation proceeding as new evidence comes to light.

Revenue risk

Revenue risk is the risk of monetary loss – in particular, our ability to collect revenue. The broader revenue implications must be considered. For instance:

- whether the taxpayer has a novel or arguable defence that has the potential to affect our well-settled processes
- our position on a particular matter in the proceeding has not yet been settled
- settling the wrong cases may result in more litigation, or our recovering less money than we would if judgment was obtained
- not settling a matter which may have precedential value or highlight the need for legislative reform.

Reputational risk

Reputational risk refers to the perception of the ATO. Litigation proceedings may affect our standing with the government, judiciary, other government agencies, external advisors or the community.

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

You must therefore consider each case on its merits, with reference to the principles set out in this practice statement.

If we are not seen to be applying settlements consistently, community confidence in the ATO may be reduced by perceptions of unfairness from those taxpayers that comply with their payment obligations.

Compliance risk

Compliance risk is an acknowledgment that a number of factors can influence taxpayer behaviour in complying with the law. It is the current and prospective risk to revenue arising from non-compliance with tax laws and precedential ATO views.

Our decision on whether or not to settle can influence taxpayer behaviour in complying with the tax law. For example, settlements that treat taxpayers differently or do not accord with the ATO view can undermine community confidence in the tax system and negatively impact voluntary compliance.

Compliance is also linked to legal risk. For example, litigating a matter with unique factual circumstances may result in ambiguity in the law or in our position. This can have wider compliance and revenue impacts for the ATO.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from unforeseeable events.

Practical examples of operational risk include:

- the availability of staff
- the inability to produce evidence of the taxpayer's debt because of a computer server crash
- bad weather preventing a witness attending Court.

5. Circumstances where it may be appropriate to settle

Settlement may be appropriate where:

- there is merit in the taxpayer's defence that poses legal risk to us
- there is scope to quickly resolve the dispute without expending further costs and time of litigation
- progressing a matter to trial could affect well-established principles of law or our position
- we face adverse costs orders in progressing a claim
- the costs of continuing litigation approach exceed the recoverable debt, or
- the taxpayer otherwise has a good compliance history.

6. Circumstances where it may not be appropriate to settle

Settlement may be inappropriate where:

- the outcome of the settlement would be contrary our policy or the law
- it is in our or the public interest to have judicial clarification on the issues in dispute
- there is a risk or pattern of the taxpayer dissipating or disposing of assets
- the taxpayer's defence has no merit (this does not prevent a settlement that provides for payment of the full debt over time)
- there is a flow-on compliance benefit in running the litigation through to judgment
- the proposal received by the taxpayer is better considered as a request for compromise
- it may encourage frivolous defences
- it would treat taxpayers inconsistently, or
- the taxpayer has a poor compliance history.

7. Authority to settle

The authority to settle debt litigation proceedings has extended from limited SES officers to Review & Dispute Resolution officers (EL1 and above) and Significant Debt Management EL2 officers.

Courts often require parties to participate in alternative dispute resolution (ADR) during debt litigation proceedings. Additionally, we have internal processes such as in-house facilitation to facilitate settlement discussions.

ATO officers with authority to settle must attend any ADR process. If authority lies with an SES officer who cannot attend, an appropriate officer should be given settlement parameters in attending the ADR process. An SES should then be available to contact during the process by telephone.

If you are unsure about whether an authorised officer should attend, they should contact Review & Dispute Resolution.

8. Settlement and prosecution action

If the taxpayer in a debt litigation proceeding is the subject of prosecution action (or being charged with criminal offences you should refer to Chief Executive Instruction CEI 2014/05/09 *Tax Crime and External Fraud*.

If a case falls within these guidelines, you should seek a formal written response from PGH Prosecutions on the impact of the prosecution action on any settlement. If you are unsure about the guidelines, you should also contact PGH Prosecutions.

No prosecution exemption

You do not have the authority to exempt taxpayers from prosecution. Therefore it cannot form part of any settlement.

Equally, you must not threaten prosecution action as a lever to settle cases.

9. More information

For more information, see:

- CEI 2014/05/09 *Tax Crime and External Fraud* (internal link only)
- Code of settlement
- PS LA 2011/12 *Remission of General Interest Charge*
- PS LA 2011/3 *Compromise of undisputed tax-related liabilities and other amounts payable to the Commissioner*
- PS LA 2011/14 *General debt collection powers and principles*
- PS LA 2011/16 *Insolvency – collection, recovery and enforcement issues for entities under external administration*
- PS LA 2011/17 *Debt relief, waiver and write off*

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