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## Commissioner's Powers of Settlement and Compromise

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# Commissioner's Powers of Settlement and Compromise

## **Abstract**

The Commissioner's general powers of settlement compromise are not widely understood. This article explores their meaning through an analysis of the good management rule and the requirement that the Commissioner act fairly. The United Kingdom (UK) provides recent examples of cases where the courts have closely examined these principles. These are discussed at length and considered in the context of the Australian position.

## **Keywords**

Commissioner of Taxation, tax law, settlement, compromise

## **Cover Page Footnote**

"The Commissioner's powers to compromise debts", paper presented at the Taxation Workshop, Coolumb, 8-10 November 2002.

## COMMISSIONER'S POWERS OF SETTLEMENT AND COMPROMISE<sup>1</sup>

*LJ Priestley QC*

The Commissioner's general powers of settlement compromise are not widely understood. This article explores their meaning through an analysis of the good management rule and the requirement that the Commissioner act fairly. The United Kingdom (UK) provides recent examples of cases where the courts have closely examined these principles. These are discussed at length and considered in the context of the Australian position.

This article had as its starting point a wish to understand better the Code of Settlement Practice In Respect Of Taxation Liabilities published by the Commissioner on the Internet (the Settlement Code or the Code). Some of the matters dealt with by the Settlement Code lead to a consideration of administrative law remedies, which taxpayers have tried to get via s 39B of the Judiciary Act, foiled, mostly, by ss 175 and 177 of the 1936 Income Tax Assessment Act. This is a large topic of its own linked with but separate from the main concern of this article.

Also linked is the elusive and not widely known ATO Receivables Policy. The Policy brings together in an orderly and easily understandable way a great deal of very useful information, in a number of related but different areas. These are areas which when taken piece by piece may not be particularly difficult, but for my part I have found it awkward to locate them quickly and also to see the relationships between them.

Going through this Policy has brought home to me that there are two distinct areas within which the Commissioner may compromise and settle disputed and undisputed tax liabilities, penalties and interest claims. Within the two areas there are further subdivisions, which I cannot go into here.

One of the two main areas is what I call the Commissioner's general powers of compromise. That is the area dealt with by the Settlement Code.

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1 *'The Commissioner's powers to compromise debts'*, paper presented at the Taxation Workshop, Coolum, 8-10 November 2002.

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The other main area is that covered by the Receivables Policy, which sets out the Commissioner's approach to making agreements to arrangements to vary the taxation obligations of taxpayers which are not in dispute: these words are a paraphrase of parts of paragraphs 1.3.10 and 1.3.11 of the Policy. These arrangements may be realistically regarded as a form of compromise or settlement, although usually of a different kind from those dealt with by, what I have called the Commissioner's general powers of compromise.

So, the title for this article covers not one, but two topics, which deserve separate treatment. One is the Commissioner's general, and the other his special, powers of compromise. Each of these leads to the other topic already mentioned, the various proceedings which may be taken (mostly) in the Federal Court to challenge administrative decisions of the Commissioner and his officers.

This article is confined mostly to the topic of the Commissioner's general powers of compromise. However, readers should note that there is much more to the Commissioner's power of compromise than the general power. They should also be aware of the practical usefulness of the Receivables Policy.

I begin discussion of the Commissioner's general powers of compromise by observing that in my experience most people, including judges, seem to accept the proposition that all taxpayers should be treated the same way, which requires that whatever tax law is applicable to a particular taxpayer should be applied to that taxpayer so that the tax payable under the applicable law is levied upon that taxpayer.

Equally, however, I think most people expect that the tax authority (with us, the Commissioner), who does not have unlimited funds to administer the tax law, will use those funds sensibly, and in doing so will recognise that uncertainties in the law, difficulties in finding facts, and often combinations of these, make it prudent, on some occasions, to compromise with a taxpayer in regard to the amount of tax owing by the taxpayer for a particular tax year.

These two lines of thought are reflected in the Assessment Acts and in the Administration Act.<sup>2</sup> The way in which the Commissioner deals with the conflicts arising from them is broadly set out in his Settlement Code.

In one of the cases, the first line of thought was epitomised in the phrase 'Not a penny more, not a penny less'. The Commissioner speaks of the second line of thought as 'the good management rule'.

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2 *Income Tax Assessment Act 1936* (Cth) (1936 Act) and *Income Tax Assessment Act 1997* (Cth) (1997 Act) and *Taxation Administration Act 1953* (Cth) (TAA).

## Not a penny more, not a penny less

In this section I set out a few examples of different ways in which this idea has been expressed over the years.

In *FCT v S Hoffnung and Co Ltd*,<sup>3</sup> there was a challenge to an assessment made under the Wartime Profits Tax Assessment Act 1917 (Cth).

The parties admitted the facts for the purposes of the appeal. Paragraph 7 of the admitted facts read:

The assessment originally and as altered up to 13 January 1922 did not include any deduction for excess profits duty paid in the United Kingdom under subs (4) of s 15 of the said Commonwealth Act, the Commissioner intimating when making such assessment that this matter remained to be adjusted and that pending such adjustment payment of tax was to remain in abeyance.<sup>4</sup>

It was held that no assessment had been made. In passages, the only part of which relevant to the present point is that which I have italicised, but which I have included because of their connection with points to be made later, Isaacs J said:<sup>5</sup>

But all this depends on whether the assessment of 26 April 1919 was an 'assessment' contemplated by the Act and whether the notice of that date was a notice intended by the Act. In the first place, the notice itself does not on its face bear out those requirements. It describes the matter as 'tentative'. The 'assessment' and the notice of assessment required by the Act to fix the taxpayer with liability for a Crown debt carrying interest and penalties must be definite and certain, or, as it has been described throughout the argument, 'definitive', as opposed to 'provisional'. There is no evidence, or at all events no satisfactory evidence, to displace the self-description in the notice. The facts as admitted and the correspondence taken as a whole confirm the apparently provisional character of the assessment and notice. Since the apparent, that is, the 'tentative', character of the departmental operation emanates from the Tax Office, the burden rests on the

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3 (1928) 42 CLR 39.

4 Ibid 41.

5 Ibid 54-5.

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Commissioner to displace it. The more is this so when it is sought to shut the taxpayer out from establishing, if he can, a right he asserts is given to him by statute.

Later, his Honour observed:<sup>6</sup>

If an assessment definitive in character is made, it assumes that, so far as can there be seen, *a fixed and certain sum is definitely due, neither more nor less. In short, it ascertains a precise indebtedness of the taxpayer to the Crown.* But if an assessment is made which recognises that one matter is unsettled and remains for settlement, and until it is settled - and probably to the advantage of the taxpayer - then, if that is the basis of the assessment, it is not the assessment contemplated by the Act. Every assessment, of course, contemplates that it may appear thereafter that an alteration or addition is necessary. But that is a different thing - there is no then existing matter known to be a presently necessary factor and put aside for future adjustment. Reading the combined evidence as reasonably susceptible of two interpretations, and therefore as raising a fair matter of contest, I adopt the one which seems to me to operate in fact more justly.

In *Lighthouse Philatelics v FC of T*,<sup>7</sup> the Full Federal Court held that the former s 190 (a) of the 1936 Act empowered the Tribunal to permit the taxpayer to amend an objection disallowed by the Commissioner in a way which would raise completely new grounds. The court said:<sup>8</sup>

Nor does the fact that the proceedings in the Tribunal or the Court are expressed to be a review or an appeal, as the case may be, in relation to the Commissioner's decision on the objection assist the Commissioner. The Commissioner cannot be said to be confined in the course of considering the taxpayers "objection" to the matters raised by the taxpayer in that "objection". He has an obligation to administer the Act and may determine to allow the objection for grounds totally unrelated to those raised by the taxpayer, if that be the correct course, just as he could form the view, based on a reconsideration of the matter, that the assessment should be confirmed for

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6 Ibid 55.

7 (1991) 91 ATC 4942.

8 Ibid 4948 (emphasis added).

reasons which he had not previously considered. *His task is to ensure that the correct amount of tax is paid, "not a penny more, not a penny less".*

In the *Commissioner of State Revenue (Victoria) v Royal Insurance Australia Ltd*,<sup>9</sup> the facts were that Royal Insurance had overpaid the Commissioner a considerable sum of stamp duty. The Commissioner resisted proceedings by Royal Insurance for recovery on the basis that he had a discretion under s 111 of the Stamps Act to refuse to make the repayment. He relied on the argument, amongst others, that the overpaid duties belonged to the insurance company's policyholders whom it would be extremely difficult for the insurance company to repay; thus probably, it was said, the insurance company would be left with a windfall.

Section 111 provided that in the case of overpayment of duty, the Commissioner 'may refund... the amount... overpaid.' Mason CJ, although he did not think the section *obliged* the Commissioner to repay, nevertheless did not think either that the section was a source of authority for the Commissioner to retain the money. He said:<sup>10</sup>

In approaching that question [of the exercise of discretion], the first and foremost consideration is that the Act is a taxing Act and that in terms it confers no authority upon the Commissioner to levy, demand or retain any monies otherwise than in payment of duties and charges imposed by or pursuant to the Act. In that context, there is no persuasive reason why the grant of a positive discretionary power to make a refund, once an overpayment of duty has been found by the Commissioner to have taken place, should be treated as a source of authority in the Commissioner to retain the overpayment in the absence of circumstances disentitling the payout from recovery. Nothing short of very clear words is sufficient to achieve such a remarkable result. The Court should be extremely reluctant to adopt any construction of s 111 which would enable the Commissioner by an exercise of discretionary power to defeat the taxpayer's entitlement to recover an overpayment of duty.

Mason CJ went on to say that although the Commissioner was not bound under s 111 to return the money, restitutionary principles were applicable to the case and since none of the possible defences to a restitutionary claim (such

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9 (1994) 182 CLR 51.

10 Ibid 64.

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as change of position) was available to the Commissioner, she would be ordered to refund the overpayments. He said:<sup>11</sup>

Whether a passing on "defence" should be recognised must be considered at two levels: the levels of public law and restitutionary law. There is the fundamental principle of public law that no tax can be levied by the executive government without parliamentary authority, a principle which traces back to the Bill of Rights... In accordance with that principle, the Crown cannot assert an entitlement to retain money paid by way of causative mistake as and for tax that is not payable in the absence of circumstances which disentitle the payer from recovery. It would be subversive of an important constitutional value if this Court were to endorse a principle of law which, in the absence of such circumstances, authorised the retention by the executive of payments which it lacked authority to receive and which were paid as a result of causative mistake.

### The Good Management Rule – Fayed

Paragraph 1.1.1 of the Settlement Code states:

It has been accepted for a very long time that settling matters is consistent with good management of the tax system, overall fairness and best use of Australian Taxation Office (ATO) and other community resources. This has become known as "the good management rule", which has been endorsed by the courts.

There is no reason to doubt, and all experience supports the accuracy, as a matter of fact, of the first sentence in paragraph 1.1.1. However, I have not been able to find any extended judicial discussion, in Australia, of the Commissioner's general powers of settlement. Much of what is said in the Settlement Code seems to be derived from the Fleet Street Casuals case in the House of Lords, which I will be referring to later.<sup>12</sup> Two Australian cases are referred to in paragraph 3.1.1 of the Code in support of the paragraph I have quoted; these are *Precision Pools Pty Ltd v Commissioner of Taxation*,<sup>13</sup> and

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11 Ibid 67.

12 *Inland Revenue Commissioners v National Federation of Self-Employed and Small Business Ltd* [1982] AC 617.

13 (1992) 37 FCR 554; 92 ATC 4549.

*Grofam Pty Ltd v FCT*,<sup>14</sup> but there is very little discussion of the basis of the Commissioner's powers in them, although they are quite consistent with what the Code says.

In *Grofam*, the court said the Commissioner's power derived from s 8 of the 1936 Act, the full text of which stated, 'The Commissioner shall have the general administration of this Act.' (The same words appear in s 3A of the TAA.)

In paragraph 3.2.1 of the Code, the good management rule is said now to be reinforced by s 44 of the Financial Management and Accountability Act 1997 (Cth). That section requires the Commissioner to manage the affairs of the ATO 'in a way that promotes proper use of the Commonwealth resources' for which the Commissioner is responsible. 'Proper use' is defined in s 44 (3) as meaning 'efficient, effective and ethical use'.

In the United Kingdom the first of the two lines of thought I have mentioned is more explicit than in the Australian legislation. There, s 13 (1) of the Inland Revenue Regulation Act provides, 'The Commissioners shall collect and cause to be collected every part of inland revenue, and all money under their care and management, and shall keep distinct accounts thereof at their chief office'.

Nevertheless, the good management rule is given full scope there also, on a basis which appears to be similar to that to which the Code ascribes it here. The (UK) Taxes Management Act 1970 says in s 1 (1) that 'Income tax, corporation tax and capital gains tax shall be under the care and management of the Commissioners...'

Two decisions from the United Kingdom throw some light on the matter, the Fleet Street Casuals case, the full title of which is *Inland Revenue Commissioners v National Federation of Self-Employed and Small Business Ltd*,<sup>15</sup> and *Fayed v Clark*.<sup>16</sup> The second of these two cases was decided on 31 May 2002, largely basing itself on the Fleet Street Casuals case. It deduced from it, and stated in a helpful way, a number of propositions concerning the powers of the revenue authority. Since these are helpful in understanding the Australian position also, I will summarise *Fayed*.

The case involved the Ali Fayed family of Harrods and other fame. There were a number of taxpayer parties, petitioners, against the IRC, all related to Mr Ali Fayed, but as he was the principal person involved I have shortened the name (not uniformly spelt throughout the case) and refer only to him, as 'Fayed'.

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14 (1997) 36 ATR 493.

15 [9082] AC 617.

16 [2002] *Simon's Tax Cases* 910. See also at <<http://www.scotcourts.gov.uk/opinions/FAYED3005.html>> (1 March 2003).

## **Fayed: the facts**

The Inland Revenue Commissioners (IRC) accepted Fayed as resident but not domiciled in the UK. Therefore, he was chargeable to income tax and capital gains tax on UK source income and capital gains, but chargeable to income and capital gains tax on foreign source income and capital gains only on the 'remittance basis'.

It seems to have been common ground at the hearing that any tax on foreign remittances is avoidable (for those who can afford it) by careful and expensive planning, and further that for the IRC to check on whether such planning has been successfully carried out is likewise time-consuming and expensive. The IRC had in several cases dealt with this problem by making forward tax agreements under which an individual agreed with the IRC to pay specified annual sums in respect of specified future years of assessment. The IRC accepted these sums in lieu of tax on remittances.

In late 1985, it was agreed that Fayed would pay £2.55 million as income tax for the past 13 assessment years to 1985-1986, and that from 1986 onwards, annual income would be declared sufficient to give rise to a tax payment of £150,000 (indexed). This agreement was acted on up to and including assessment year 1990-1991.

From the time of the making of the agreement, Fayed did not arrange to ensure that only capital was brought into the UK.

In 1990 a dispute on foot between the IRC, Fayed family members and companies was settled by an agreement under which Fayed paid £31 million and the IRC agreed to take no proceedings of any kind concerning tax against Fayed in respect of the past.

For the future, another forward tax agreement was made under which Fayed was to pay £200,000 each year to 1996-1997 in full settlement of any possible tax on remittances. The agreement also noted that during 1996-1997 discussions would be held to negotiate a continuation of the agreement for a further six years.

The IRC did not seek legal advice before making either of the forward tax agreements.

As the time approached for discussion for a renewal of the second forward tax agreement officials within the IRC began to debate whether, as a matter of policy, such arrangements should continue in a self-assessment environment, which was about to be introduced. In one memorandum in which the pros and cons were discussed, an official wrote, 'Also on the benefit side the ownership of

UK properties by an offshore company and the shadow director arguments which inevitably flow from such arrangements are still settled by horse trading as opposed to on any strict statutory basis. There are still no cases before the court testing this issue.'

After getting advice from the Solicitor of Inland Revenue and more information from Fayed's accountants, further negotiations took place and a third agreement was made, for assessment years 1997-1998 to 2002-2003, for £240,000 each year. The IRC sought no further legal advice before entry into this agreement.

One part of the agreement made it clear that Fayed would complete Tax Returns each year but that the section of the Tax Returns requiring details of foreign source income and capital gains would be completed 'as per the Agreement'. The balance of the return would be assessable in the normal way.

The next stage of the story came about when, as the judge remarked (in a wonderful understatement), as a result of various court proceedings in which aspects of Fayed's affairs were revealed, by the end of 1999 'there was a general feeling among the senior management of [the IRC in Edinburgh] that they did not have a complete picture of Fayed's financial affairs'. As a result, they thought that the 1997 agreement should be terminated, if possible.

On 7 March 2000, a mid-level official in Edinburgh wrote to Fayed's accountants saying that because of press reports about Fayed's ready access to extremely large sums of cash, the agreement was suspended and the latest £240,000 cheque returned. This notice was given without giving Fayed any opportunity to make representations.

The judge said that the official did what he did without legal advice and had no clear idea as to what 'suspension' of the agreement meant. During March, April and May 2000, the judge said, much of the effort by the IRC was taken up by an attempt to frame a coherent response to Fayed's request for an explanation.

The IRC sought advice from counsel who said that there was no contractual basis for not abiding by the agreement, but that it might nevertheless have been ultra vires. Senior officials had doubts about the justifiability of the suspension letter and sought further advice from counsel on whether it was possible to 'extricate' the department from the 1997 agreement.

It was recognised by the senior officials that Fayed's case could not be dealt with in isolation. Apparently, the professional advisers were aware of other forward agreements that had been made, so that if the IRC tried to break Fayed's agreement without assessing the efficacy of the others they would face allegations of dealing with Fayed unfairly.

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On 10 May, the IRC received counsel's opinion that the 1997 agreement was ultra vires. On 30 May, solicitors for Fayed wrote saying the suspension of the 1997 agreement was unlawful because it was unfair, an abuse of power and because the IRC had given no adequate reason for it. They threatened action if an appropriate reply was not received by 2 June. On 2 June, the IRC handed letters to Fayed's representatives saying the agreement was not enforceable because it was ultra vires. They would accept it as having operated to 5 April 2000, but from that date, tax returns would have to be made without reference to the agreement. At meetings with Fayed's advisers on that day the IRC said they intended to do a full investigation of the Fayed family. The advisers wrote saying that the change of stance and the intention to investigate were evidence of abuse of power.

### **Court proceedings: the judge's decision**

Fayed then brought a petition in the Court of Session in Scotland seeking a declaration that the IRC were bound to abide by the 1997 agreement.

After setting out the facts, the judge, Lord Gill, noted that the parties were agreed that if the 1997 agreement was not ultra vires, the IRC were in breach of it and the petition must be granted. If the agreement was ultra vires, a question arose whether the petition should nonetheless be granted (a) because the IRC retained a discretion to abide by it, (b) because the IRC had abused its power, and/or (c) because Fayed's Convention rights had been infringed.

The judge decided the forward tax agreement had been ultra vires of the IRC. In coming to this conclusion he referred first to s 13(1) of the Inland Revenue Regulation Act (above), which required the Commissioners to 'collect and cause to be collected every part of Inland Revenue' and then to the provision in the Taxes Management Act (above), which provided that 'Income tax, corporation tax and capital gains tax shall be under the care and management of the Commissioners of Inland Revenue...'

He then stated a number of general propositions, (which I have condensed into the following list):

1. In general, the IRC have a wide discretion in the exercise of their duties of care and management and the court will interfere only where the discretion has been exercised unreasonably or illegally.
2. In the everyday performance of their duties under s 13(1) the IRC have to balance the duty to collect every part of Inland Revenue with their other, general duties. This involves, amongst other things, the making of

judgments as to the best deployment of their resources in maximising the collection of tax known to be due and the making of judgments as to the extent of the information they can reasonably hope to obtain in their investigation of the affairs of taxpayers or potential taxpayers.

3. The IRC may make settlements, in respect of past tax, which involve compromising and settling for less than the tax which may be due or which they know to be due. For this the judge drew on the Fleet Street Casuals case. In this case the IRC were held to have acted within the scope of their lawful discretion, when, to secure acceptance by a trade union of a special arrangement that would ensure that, for the future, tax would either be deducted at source or properly assessed, the IRC agreed not to investigate tax lost in previous years. (The judge later said that there was no dispute that there was a liability to tax on the part of the individuals who, as a result of the special arrangement, would not be investigated and therefore would not pay the past avoided tax.)
4. In looking at the terms on which such settlements are made, the court will not substitute its own judgment for that of the IRC merely because the Court thinks a settlement may have been unwise from the IRC's point of view.
5. The court *will* interfere in such a case if the IRC have exercised their discretion unreasonably in the Wednesbury sense, but in considering that question, the IRC's judgment is not to be lightly cast aside.
6. Provided the decision is made in good faith in pursuance of proper care and management purposes and solely for 'good management' reasons, it will be *intra vires*.
7. There is a distinction between agreements for the settlement of disputes about past unpaid taxes and agreements concerning future taxes.
8. In settlements of the former kind the IRC are, in general, exercising their functions under the sections from the Inland Revenue Regulation Act and the Taxes Management Act. The judge said, 'One can readily understand that the [IRC] could agree with a taxpayer to compromise in relation to the amount of the taxpayer's undisputed liability to tax in circumstances where the [IRC] would find it difficult accurately to assess the extent of the liability and economic cost or within reasonable time'.
9. For future tax, it is within the proper scope of care and management for the IRC to give advance guidance as to the tax treatment of a proposed transaction where all relevant circumstances attending the transaction are fully disclosed, even if that guidance involves the IRC's foregoing tax that

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might arguably be payable on proper construction of the legislation. This is on the basis that the taxpayer will carry out the proposed transaction in accordance with the taxpayer's representations to the IRC.

However, the judge was of the opinion in the case before him that the forward tax agreement could not be equated either to settlement of past tax or advance guidance. He said that the tax agreement in question had been arrived at as follows:

On the threat that the other party may avoid any liability to pay United Kingdom tax at all, the [IRC] accepted payment of a fixed sum that entitles the other party to receive foreign remittances in the United Kingdom of any amount, and even if they represent income or capital gains, during the period of the agreement.

The judge went on to say that the receipt of the fixed sums paid under the agreement could not 'be characterised as a collection of Inland Revenue', and continued

In my opinion the [IRC] do not have power to enter into agreements for the payment of money to them by an individual on the basis that the individual could so organise his affairs as not to incur any liability to United Kingdom tax.

The making of the forward tax agreement was therefore not a proper exercise of the IRC's duties of care and management. Or, the judge added, putting it in another way, the IRC's duty to collect tax lawfully due arises only where transactions have occurred that create a liability to tax.

The judge, having found the agreement was beyond the powers of the IRC, went on to consider another ground which it had been submitted for the IRC led to the same result, namely that Fayed had given the IRC inadequate factual information. The judge found that the IRC had indeed had inadequate factual information, but that this was not the fault of Fayed, but of the IRC. Nevertheless, he regarded this lack of information as relevant to the invalidity of the agreement, because it confirmed his conclusion that in making the 1997 agreement the IRC were in effect stepping outside the taxation system.

A further reason for the invalidity of the agreement was that it contained no provision for termination during its term; if a material change of circumstances occurred, for example, a change of legislation affecting Fayed's domicile, the continuation of the agreement would take the parties even further outside the taxation system.

Finally, on this point, he said:

The agreement was ultra vires in principle by reason inter alia of the fact that it bound the [IRC] to an agreement that throughout its contractual currency [Fayed] would be regarded as domiciled outwith the United Kingdom, even if the acquisition of a domicile in the United Kingdom during that period were to alter fundamentally the nature of [Fayed's] liability to United Kingdom tax. The [IRC] therefore bound themselves to an agreement which, in that event, would become contrary to law.

The remaining matters for the judge to consider were whether the IRC had a discretion still to abide by the agreement, whether there had been an abuse of power and whether there had been a breach of Fayed's rights under the Convention.

The judge did not think the IRC had any discretion to abide by the agreement. Since the agreement was ultra vires, the IRCs' duties remained in force and remained to be implemented by the IRC.

Similarly, in regard to abuse of power, the judge thought that nowadays that must be considered within the overall doctrine that public bodies must act fairly and that, since the agreement was ultra vires, it could not be unfair for Fayed to be deprived of its benefits. Alternatively, a taxpayer can have no legitimate expectation of benefiting from an act of the IRC beyond their power and the court could not in effect compel a statutory body to exceed its powers.

On this point, it had been submitted for Fayed that he had been prejudiced by the termination without notice. The judge held there was no evidence of this. He also added, interestingly,

When the petitioners have made tax returns on the appropriate statutory basis, when the facts are known and when the [IRC] have made such assessments, if any, as they consider appropriate, the [IRC] will retain a discretion to avoid such prejudice to the petitioners and to mitigate their position suitably. If the treatment of the matter at that stage is not satisfactory to the petitioners, the petitioners will have a right of recourse to the court.

As to the Convention point, he held that the Act relied on, (the Human Rights Act 1998), had no effect on the situation because it had come into force after the making of the agreement.

The petition was therefore dismissed.

### **The Commissioner's duty to (a) administer the Act in accordance with the good management rule and (b) to act fairly**

The paragraph last quoted from the opinion of the Scottish court seems to be a reference to a duty of the revenue authority to act fairly towards the taxpayer, with the possibility of judicial review if the revenue authority acts in breach of that duty. If that was what was intended, it was probably based upon some observations made in the House of Lords in the Fleet Street Casuals case.<sup>17</sup>

This case arose from the fact that about 6000 casual workers in Fleet Street had adopted a fraudulent system of drawing their pay which they had used over a number of years and which was estimated to cause a loss of revenue of about £1 million a year. When the revenue authorities began to investigate the fraudulent practices, they concluded that it would be impossible to collect all the evaded tax. The value of the resources that would have been needed even to make the effort would have been greater than what could have been expected to be collected. After lengthy negotiations, an arrangement was made, with the cooperation of both the employers and the unions of the casuals, pursuant to which all tax would be effectively collected in the future. In return, no investigation into tax lost before the 1977 tax year would be carried out.

The National Federation of Self-Employed and Small Businesses Ltd applied to the court for an order that the Inland Revenue Commissioners assess and collect all the arrears of income tax due by the 'Fleet Street casuals'.

The House of Lords held that the Federation had no standing to bring the proceedings. However, each of their Lordships had something to say, interesting for present purposes.

Lord Wilberforce said that, in principle, the IRC were an administrative body which the courts could supervise. A taxpayer could get a remedy from the court if he could show that the revenue had either failed in its statutory duty toward him or had been guilty of an abuse of power or had acted outside power altogether. He thought it would be rare for that to happen, but that the possibility certainly existed.

He then moved to the question whether one taxpayer could challenge an assessment made (or not made) upon another taxpayer. Here, he began by

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17 *Inland Revenue Commissioners v National Federation of Self-Employed and Small Business Ltd* [1982] AC 617.

remarking that in local government law, ratepayers had a sufficient interest in the rates levied upon other ratepayers to challenge the assessments of rates upon those other ratepayers. He then continued:<sup>18</sup>

The structure of the legislation relating to income tax, on the other hand, makes clear that no corresponding right is intended to be conferred upon taxpayers. Not only is there no express or implied provision in the legislation upon which such a right could be claimed, but to allow it would be subversive of the whole system, which involves that the Commissioner's duties are to the Crown, and that matters relating to income tax are between the Commissioners and the taxpayer concerned. No other person is given any right to make proposals about the tax payable by any individual: he cannot even inquire as to such tax. The total confidentiality of assessments and of negotiations between individuals and the revenue is a vital element in the working of the system. As a matter of general principle I would hold one taxpayer has no sufficient interest in asking the court to investigate the tax affairs of another taxpayer or to complain that the latter has been under-assessed or over-assessed: indeed, there is a strong public interest that he should not. And this principle applies equally to groups of taxpayers: an aggregate of individuals each of whom has no interest cannot of itself have an interest.

That a case can never arise in which the acts or abstentions of the revenue can be brought before the court I am certainly not prepared to assert, nor that, in a case of sufficient gravity, the court might not be able to hold that another taxpayer or other taxpayers could challenge them. Whether this situation has been reached or not must depend upon an examination, upon evidence, of what breach of duty or illegality is alleged. Upon this, and relating it to the position of the complainant, the court has to make its decision.

He then examined the facts in detail and concluded that,<sup>19</sup> 'On the evidence as a whole, I fail to see how any court...could avoid reaching the conclusion that the Inland Revenue...were acting in this matter genuinely in the care and management of the taxes, under the powers entrusted to them.'

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18 Ibid 633.

19 Ibid 635.

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Lord Diplock said that, the Board of Inland Revenue, in the exercise of their functions,<sup>20</sup> 'have a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge, the highest net return that is practicable having regard to staff available to them and the cost of collection.'

A little later he said he had no doubt:<sup>21</sup>

that if it were established that the board were proposing to exercise or to refrain from exercising its powers not for reasons of "good management" but for some extraneous or ulterior reason, that action or inaction of the board would be ultra vires and would be a proper matter for judicial review if it were brought to the attention of the court by an applicant with "a sufficient interest" in having the board compelled to observe the law.

His conclusion on the facts in the case was that the Federation did not have a sufficient interest to justify its being able to continue with the proceedings.

Lord Fraser took much the same line, indicating that he thought it unlikely that a taxpayer could ever show a sufficient interest. He did say however,<sup>22</sup> 'It may be that, if he [a taxpayer] was relying upon some exceptionally grave or widespread illegality, he could succeed in establishing a sufficient interest, but such cases would be very rare indeed and this is not one of them.'

Lord Scarman wrote one paragraph, which has been much quoted since:<sup>23</sup>

I do not accept that the principle of fairness in dealing with the affairs of taxpayers is a mere matter of desirable policy or moral obligation. Nor do I accept that the duty to collect "every part of inland revenue is a duty owed exclusively to the Crown... I am persuaded that the modern case law recognises a legal duty owed by the revenue to the general body of the taxpayers to treat taxpayers fairly; to use their discretionary powers so that, subject to the requirements of good management, discrimination between one group of taxpayers and another does not arise; to ensure that there are no favourites and no sacrificial victims. The duty has to be considered as one of several arising within the complex comprised

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20 Ibid 636.

21 Ibid 637.

22 Ibid 647.

23 Ibid 651.

in the care and management of the tax, every part of which it is their duty, if they can, to collect.

Lord Scarman, like the others, also reached the conclusion that the Federation had not shown a sufficient interest to justify its being allowed to take the case further. He did so on the basis that the evidence before the court, (although only at an interlocutory stage) quite clearly showed that the revenue had not failed in its statutory duty. That being so, there was no sufficient interest. He added:<sup>24</sup>

Had they shown reasonable grounds for believing that the failure to collect tax from the Fleet Street casuals was an abuse of the revenue's managerial discretion or that there was a case to that effect which merited investigation and examination by the court, I would have agreed with the Court of Appeal that they had shown a sufficient interest for the grant of leave to proceed further with their application.

Lord Roskill did not join with Lord Scarman in his above quoted paragraph, but did agree with him in regard to the failure by the Federation to show a sufficient interest. On this point, he said:<sup>25</sup>

To my mind it is clear beyond argument...that what was done was a matter of taxes management...what they did seems to me to have been a matter of administrative commonsense. Instead of wasting public time and money in seeking to collect taxes from persons whose names were unknown and whose ability to pay was therefore equally unknown, they made an arrangement which enabled taxes not hitherto able to be collected or in fact collected, collectable in the future at a cost to the general body of taxpayers of foregoing the collection of that which in reality could never have been collected.

## **The Australian position**

The same twofold position appears in the Australian authorities.

Repeating what I said earlier, the Commissioner's general power to settle has been put upon the basis of the provisions which give him the general

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24 Ibid 655.

25 Ibid 663-664.

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administration of the relevant Acts; see s 8 of the 1936 Act and s 3A of the TAA.<sup>26</sup>

The same position also appears in regard to administrative review. Although Lord Scarman's quoted paragraph received some support in the UK,<sup>27</sup> and has been mentioned without disapproval in Australian cases,<sup>28</sup> the effect of ss 175 and 177 of the 1936 Act has been regarded, as it was in *David Jones Finance*, as strong enough to guard against any but exceptionally powerful cases alleging invalidity of assessments.

A comparatively recent example is *Young v FC of T*.<sup>29</sup> In that case, Gyles J held that the Commissioner had bound himself to deal with taxpayers in accordance with a media release in which he announced that tax deductions claimed by taxpayers who had participated in linked bond or note arrangements would be disallowed and that taxpayers would have three options from which they could choose in response to the policy announcement. It is not completely clear, but it seems that his Honour regarded such a fettering of his discretions by the Commissioner as unlawful. Whether or not he in fact committed himself to that proposition, he dealt with the case on that footing.

On the assumption that the Policy was unlawful, Gyles J decided that, in the exercise of his discretion he would grant no relief. He based this decision on the combined effect of a number of considerations. The first was that the applicant could only be concerned with the Policy so far as it affected him. The judge did not consider that the Policy affected the applicant adversely. Next, nothing adverse to the applicant could happen until an assessment was issued. Then, the preclusive effect of ss 175 and 177 of the 1936 Act would operate to prevent challenge of the assessment except in accordance with the procedures available under Part IVC of the Taxation Administration Act.

He then listed the chief cases in which attempts to obtain relief by judicial review had been thwarted by the operation of those provisions.<sup>30</sup> The cases almost uniformly recognise that judicial review is, in theory, available, but the preclusive ss 175 and 177 usually prevent the putting of relevant evidence before the court. Since these cases are not directly relevant to my topic, I will not go into further detail about them, except for two comments.

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26 These were the sections mentioned in *Grofam Pty Ltd v FC of T* 97 ATC 4656, 4665 per Sheppard, Foster and Whitlam JJ.

27 See *R v IRC; ex parte Preston* (1985) 1 AC 835.

28 See *David Jones Finance and Investment Pty Ltd v FC of T* 90 ATC 4730; *Darrell Lea v C of T* (1996) 72 FCR 175 and *Bellinz v FCT* 98 ATC 4634.

29 2000 ATC 4133.

30 *Ibid* 4141.

First, they all acknowledge that the grounds on which an administrative decision would be held invalid, given by Dixon J in *R v Hickman*,<sup>31</sup> will be available only if appropriate evidence can be put before the court.

Second, there are in fact (at least) two instances where judicial review has succeeded: *Briggs v DFC of T*<sup>32</sup> and the Darrell Lea case.<sup>33</sup> In each of these two cases, the taxpayer was able to show, in the first case by admissions by the Commissioner, and in the second case by deduction from the making of multiple assessments claiming the same tax, that the Commissioner had not made an assessment at all, or was acting on the basis of facts known to be wrong in purporting to assess.<sup>34</sup>

## The Code

The current version of the Code has been available since 4 January 2001. In general, it is consistent with the propositions earlier extracted from the Fayed case. It lays down a number of sensible rules, particularly for the information of relevant officers of the Commissioner.

Two features deserve some mention here. One is that paragraph 3.2.6 states: 'The good management rule would also support an advanced pricing arrangement with a multinational corporation designed to settle cross jurisdictional disputes for an agreed future period.'

There does not appear to be a statutory basis for an advanced pricing arrangement beyond the very general sections already mentioned from which the good management rule is derived. If that is the only basis, then it is possible that Lord Gill's views would be relevant in Australia. However, there is a settled routine by which the ATO enters into advanced pricing arrangements, sometimes involving foreign tax authorities. In cases where both the ATO and a foreign tax authority are involved, the valid authority for the arrangement is likely to be contained in a relevant double tax agreement.

Leaving those arrangements aside, parties seeking to enter into advanced pricing arrangements will need to be careful to avoid situations such as that which was criticised, and indeed, said to be ultra vires, in Fayed.

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31 (1945) 70 CLR 598.

32 86 ATC 4748.

33 Above n 28.

34 There are other recent examples of the width now available of judicial review of various discretions exercised by the Commissioner by reference to his various Code and policy statements. See *Elias v FC of T* 2002 ATC 4579 and 4761 and *Carey v Field* 2002 ATC 4837.

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A final interesting aspect of the Fayed case was noted in the *Financial Times* of 14 August 2002:

Following the decision of the Court of Session in Edinburgh in May 2002 which ruled the special tax agreement between the Inland Revenue and...Fayed was unlawful, the Inland Revenue has not yet brought the agreement to an end. The forward tax agreements enjoyed by foreign nationals who live in the UK but are not UK citizens and which allow for agreed lump sums to be paid over a number of years instead of annual tax assessments being made, are to run their expected course and not be renewed instead of being terminated early.

This decision seems to show a misunderstanding on the part of the Inland Revenue of the court's judgment. Perhaps, however, it was properly understood, in which case the Inland Revenue's decision may have been based on an idea of fairness to other parties who had entered into forward tax agreements. Possibly, also, the arrangements made with the other parties had taken a form not subject to the criticism, which rendered Fayed's agreement *ultra vires*. In Fayed's case itself, in the absence of further information, it is hard to understand the Inland Revenue's position.

The other matter to mention concerning the Code is that it contains a number of rules intended to promote fairness and transparency. One of these (7.8) states: 'Settlements, including their justification or underlying reasoning, must be recorded either on the case management systems or some other database. The central register of settlements will be accessible by the Commissioner on the Taxlan.'

Presumably, the central register is for the benefit and use of the Commissioner and his officers. Despite the fact that it will contain many details conventionally treated as highly confidential, and that this confidentiality is likely to be protected by the courts, it is not beyond possibility that it will become a target for adventurous subpoena servers. It would provide a mine of information, and might provide material supporting arguments of discrimination between taxpayers, if, against the odds, it could be opened up.