95 Waller Place
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5 September 2006

Committee Secretary
Joint Committee of Public Accounts and Audit
Department of the House of Representatives
Parliament House
Canberra ACT 2600 by Email jcpa@aph.gov.au

Dear Secretary

Re: **Inquiry reviewing a range of taxation issues within Australia**

I refer to my letters to the Committee dated 26 June 2006 and 15 July 2006 concerning inconsistent application of clearly enunciated ATO policy relating to compensating adjustments dating back to my 1997 to 1999 years of income.

The Commissioner has finally decided to remit the 25% penalty in full to give effect to his stated policy in public ruling TR 97/4 applicable to compensating adjustments, and to remit GIC, so that the rate applied is consistent with the interest on overpayments rate paid to my spouse.

It has taken a substantial period of time to have the Commissioner of Taxation abide by his policy stated in that ruling and as to how any officer could impose penalty in the first place is a blatant disregard of the public ruling system. Then to have senior officers persistently refuse to rectify the situation is disturbing. Attached for your information is a copy of a letter dated 23 August 2006 from the Commissioner confirming the remission of both GIC in part and the remission of the 25% penalty.

I am still perturbed at the disallowance of interest on the funds drawn down out of the redraw facility and the imposition of a 25% penalty as well the imposition of GIC. In disallowing a significant part of that interest on the redrawn funds the provisions of Section 50(a) were relied upon to disallow the amounts under Section 51(1).

My submission highlights the impact of such an interpretation on taxpayers Australia wide who co-mingle any borrowed funds with any non income related funds, including exempt income, in a working account such as a cheque account, and the inconsistencies in the Commissioner's reliance on Section 50(a) to make the disallowance under Section 51(1). Section 50(a) of the Act has no application whatsoever to an individual taxpayer. It relates solely to private companies; and that Section, since the dividend imputation system was introduced and legislation requires private companies to make sufficient distributions was withdrawn, and is no longer an active section of the Act.

The wording of Section 51(1) has no relevance whatsoever to Section 50. The wording of Section 50(a) cannot be interposed in Section 51(1), and Section 50(a) cannot be applied without due regard to the overall provisions of Section 50 as any interest allowable under Section 51(1), that cannot be directly traced to dividends under Section 50(a), is applied

under Section 50(c) to personal exertion income, and therefore Section 50 merely allocates deductible interest under Section 51(1) to three classes of income stipulated in Section 50.

As I stated in my submission the High Court of Australia in *Ronpibbon Tin* and the Federal Court of Australia has rejected a direct trace of funds to establish the deductibility of interest under Section 51(1). Further, the Commissioner in his Public Ruling TR 2000/2 talks of co-mingling of funds in a mixed purpose account, see Paragraph 15, and that ruling specifically states that a strict trace of funds is not appropriate, see paragraph 46 of the ruling.

Yet in my case the Commissioner takes an alternate view and maintains that a strict trace of funds is required for the purposes of Section 51(1) relying on the wording of Section 50(a) and maintains that where any funds are co-mingled with any other funds then a direct trace could not be established. In fact he went further than that with loan funds drawn down and deposited to my Visa account, where there were no other personal funds in the account at the time, and thus no co-mingling of funds existed, and still disallowed the interest when a clear trail to accept apportionment existed.

For the Commissioner to rely upon the decision by the High Court of Australia in *Palvestments*, that decided interest was not to be applied against dividend income to reduce the quantum of rebate of tax under Section 46, applying the formula set down in Section 50(a), as a direct trace could not be established, is fundamentally flawed in applying Section 51(1). The disputed interest in *Palvestments* was allowed under Section 51(1). That case simply decided that the deductible interest was not required to be offset under Section 50(a) because a strict trace required under that section could not be established and therefore *Palvestments* did not disallow one cent of interest under Section 51(1). The Commissioner in my case has failed to appreciate the workings of the Act and will not respond to clarify the situation to confirm he is acting consistently with how he applies Section 51(1) across the board.

The double standard the Commissioner has applied is distressing to me and then to unjustly penalize me and impose GIC is appalling.

With the interest on the redraw facility, i.e. the adjustments related to my 1997 to 1999 years of income, there was no public available policy expressed by the Commissioner as to how he viewed the operation of such accounts. The first view of how the Commissioner saw this type of account operating was expressed in public ruling TR 2000/2 which issued in the 2000 year and that was after I had lodged my 1997 to 1999 returns of income.

The bank that organized the loan facility with a redraw account had me believe that I could lodge additional funds to the account and redraw those funds as required. As my submission particularised I had deposited some $260,000 of private funds to the facility and had no intention whatsoever of using the facility for any tax mischief.

My submission also highlights that most of the redraws were replenished shortly after being redrawn and the car scenario was to reduce interest otherwise payable. The way I used the account significantly reduced deductible interest otherwise payable due to the large deposits to the redraw facility. Only a small proportion of those deposits were redrawn.

Public ruling TR 2000/2 expressed at paragraphs 48 to 52 that tax experts held a different view to the Commissioner as to whether redrawn funds were a new loan or a re-accessing of private funds deposited to the redraw facility. Therefore if I went to get advice about this prior to the issue of TR 2000/2 one ponders what advice I would have received from a request to an expert. A 25% penalty was applied to me because it was said I did not get expert advice and did not follow the content of TR 2000/2 which had not issued during the 1997 to 1999 years of dispute.

To penalize taxpayers in those circumstances and for a penalty submission not to address the factual scenario as required in TR 94/4 is an abuse of administrative power and leads to inconsistent application of the Commissioner's powers. Further, why go back 3 years before the ruling issues, to make adjustments for minimal tax collections, in circumstances where the audit staff even had difficulty interpreting the policy contained in TR 2000/2, and they had hindsight when I had no available ATO policy to follow when lodging my 1997 to 1999 returns of income?

Deductibility of interest applies to many taxpayers across Australia and if the Commissioner is going to disallow interest, where borrowed funds are co-mingled, then as I pointed out a great number of Australians would be impacted.

The impact of disallowance due to co-mingling effects every taxpayer, either operating a bank overdraft where even one cent of private funds or exempt funds are deposited, or where loan funds are drawn down and deposited to a working cheque account for disbursement, or to a taxpayer operating a cash business where borrowed funds are placed in a till with other change, if the Commissioner consistently applies the interest policy he applied to me.

As I pointed out in my submission, even when I asked for clarification during the audit of the content of TR 2000/2, the audit staff was not able to clarify my requests, so how is an individual to know the vagaries of the tax system? When the matter went to the AAT the Tribunal decided the Commissioner was wrong with the deductibility of interest on other matters and I was allowed interest that the Commissioner asserted was not allowable. That clearly shows that the Commissioner gets it wrong. In fact more than 50% of the interest disallowed during the audit was allowed by the AAT, yet the Commissioner suffers no penalty and thus highlights the difficulties in interpreting the law for both the Commissioner and a lay person.

In fact I suffered further penalty because I had to borrow funds to pay the assessments in full, including penalties and GIC, some of which had been assessed twice because the Commissioner refused to allow credit for the compensating adjustments, and then I was not permitted to deduct the interest because the funds were applied to a tax debt even though the AAT ruled the Commissioner erred in disallowing the major issue to which disallowed interest related.

It disturbs me to have penalty imposed at 25% and then additional penalty imposed in the form of GIC at inflated rates and then, when the Commissioner gets it wrong he refunds GIC at 5%, in the form of interest on overpayments, and maintains his 13% on the balance.

The taking of my case to the AAT cost the Commissioner some $25,000 when insignificant tax was involved of around $800 to $1,000 spread over 3 years. To me that is pathetic administration and I query its substance.

If the Section 50(a) position was not argued at the AAT then the redrawn funds used privately would have amounted to around $300 and if the amounts settled back to the loan account shortly after being redrawn were not disallowed, the amount in dispute would have amounted to less than $100. If this is what current taxation administrative policy is meant to achieve then as far as I am concerned it is an absolute disgrace. The public purse is over $24,000 out of pocket given the minimum tax that resulted.

Unfortunately, as I pointed out in my submission to you, the Commonwealth Ombudsman could see no wrong in the Commissioner's approach but from my viewpoint he is a toothless tiger and serves little administrative purpose. Even a lay person could read two lines of TR97/4, that clearly expresses that penalty should not have applied to the compensating adjustments (and any officer applying common sense would have remitted the GIC on those compensating adjustments as well), yet the Ombudsman relied on the Commissioner's clearly contrary advice to stated ATO policy.

The deductibility of interest impacts across many taxpayers and, if Section 50(a) is the manner in which the Commissioner wishes to interpret the law applying to Section 51(1), then he must do so consistently. He must not apply some obscure interpretation to small taxpayers that is contrary to established espoused policy, penalize them unmercifully, and then refuse to explain his situation. That conflicts directly with the undertakings of the Commissioner in the Taxpayers' Charter.

As I said in my submission reliance on Section 50(a) to disallow the interest was not mentioned to me at any time during the disallowance phase until the matter had begun being heard by the AAT. That action itself completely contradicts the content of the Taxpayers Charter where the Commissioner undertakes to explain the position he takes on an issue when stating his reasons for taking amendment action.

Again, in the Commission's letter of 23 August 2006 the situation relating to Section 50(a) is left unaddressed.

Yours faithfully

W. D. Domjan

Attachment
Letter from P. Nash Assistant Commissioner Personal Tax 23 August 2006

CC
Mr. David Vos, AM Inspector- General of Taxation
Mr. Damien Browne, Special Tax Adviser, Commonwealth Ombudsman
Mr Michael D'Ascenzo, Commissioner of Taxation
Mr. P. Nash, Acting Assistant Commissioner Personal Tax