


CR 2005/62 - Income tax: assessability of income: Australian Public Service employees deployed to the Solomon Islands

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Class Ruling

Income tax: assessability of income: Australian Public Service employees deployed to the Solomon Islands

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are section 23AG of the *Income Tax Assessment Act 1936* (ITAA 1936) and section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies are employees of the Australian Public Service (APS) deployed to the Solomon Islands under the Regional Assistance Mission to Solomon Islands (RAMSI). They are:

- APS employees deployed as part of the Economic Reform Unit;
- APS employees deployed as part of the Financial Management Strengthening Program;
- Customs APS employees deployed as part of the Customs Modernisation Program; and
- AusAID APS employees deployed as Program Development Specialists,

all of whom are collectively referred to in this Ruling as APS employees.

4. The class of person in paragraph 3 to whom this Ruling applies remain Australian residents throughout the period of their deployment.
5. The class of person does not include:
- APS employees who while on deployment to the Solomon Islands return to Australia for a period during which they utilise leave that has wholly or partly accrued from service in Australia;
 - Persons engaged in diplomatic or consular duties;
 - Members of the Australian Defence Forces and APS Employees of the Department of Defence working in the Solomon Islands as part of Operation ANODE. Class Ruling CR 2003/94 applies to these persons;
 - Australian Federal Police (AFP) personnel on long term, non-diplomatic posting to Solomon Islands under the auspices of the RAMSI. Class Ruling CR 2004/129 applies to these persons; or
 - Members of the AFP – International Deployment Group deployed to the Solomon Islands under the Instrument of Determination dated 10 December 2004. Class Ruling CR 2005/25 applies to these persons.

Qualifications

6. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
7. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 11 to 20.
8. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:
- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.

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Date of effect

10. This Ruling applies from 11 May 2004. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 to 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Arrangement

11. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- application for a Class Ruling dated 12 November 2004;
- copy of the Treaty Agreement between the Australian Government and the Solomon Islands Government covering the RAMSI deployments dated 24 July 2003 (received by facsimile on 25 November 2004);
- Guide to Conditions of Employment for deployment have been supplied in respect of each deployment program; and
- further information provided by the applicant and recorded on Tax Office systems.

12. As part of RAMSI, the Australian Government has decided to deploy APS employees to the Solomon Islands to develop sustainable economic and budget processes for that country's Government. The deployment is integral to the Australian Government's effort to provide security, law enforcement and economic stabilisation to the Solomon Islands.

13. The employees will be deployed to RAMSI for a period of at least 91 days with expected periods of between six and 24 months.

14. The assistance being provided under RAMSI is governed by the treaty, 'Agreement between Solomon Islands, Australia, New Zealand, Fiji, Papua New Guinea, Samoa and Tonga concerning the operations and status of the police and armed forces and other personnel deployed to Solomon Islands to assist in the restoration of law and order and security' (the RAMSI Agreement).

15. Article 16.6 of the RAMSI Agreement provides that members of the visiting contingent to the Solomon Islands as part of RAMSI shall be exempt from taxation by the Solomon Islands government on their pay and other emoluments. The Solomon Islands' *Facilitation of International Assistance Act 2003* gives legal effect to Article 16.6 of the RAMSI Agreement.

16. Salary will be as agreed to between employees and their respective home agencies. Salary and allowances will be paid into the employee's nominated bank account on a fortnightly basis during deployment.

17. The employees will be entitled to the following allowances:

- Cost of Posting Allowance;
- Hardship Allowance;
- Child Allowances;
- Additional Household Allowance;
- Transfer Allowance; and
- Cost of Living Allowance (applicable to Program Development Specialists).

18. Employees will be members of either the Commonwealth Superannuation Scheme, or the Public Sector Superannuation Scheme.

19. An employee will accrue recreation, personal and long service leave whilst at post. In addition, employees will receive 10 days additional recreation leave per annum or pro-rata for part of deployment.

20. Leave will be approved subject to project requirements and with approval from line management in both the employee's Australian Government Department and in-country agency. However, other than in exceptional circumstances, it is expected that only leave accrued while on deployment will be considered. Exceptional circumstances would be for example major illness of the employee or a member of their family.

Ruling

21. Subject to paragraph 22, the salary and allowances referred to at paragraphs 16 and 17 of this Ruling, derived by an APS employee described in paragraphs 3 to 5 of this Ruling deployed to the Solomon Islands as part of RAMSI, are exempt from income tax under section 23AG of the ITAA 1936 where:

- the employee has been engaged, or is taken to have been engaged, in service in the Solomon Islands for a continuous period of not less than 91 days; and
- the salary and allowances, including payments for recreation leave that has wholly accrued from the period of service in the Solomon Islands, are derived from that foreign service.

22. The Transfer Allowance referred to in paragraph 17 is not exempt from tax under subsection 23AG(1) of the ITAA 1936.

Explanation

23. Subsection 6-5(2) of the ITAA 1997 provides that the assessable income of a resident taxpayer includes ordinary income derived directly or indirectly from all sources, whether in or out of Australia, during the income year.

24. Salary and wages are ordinary income for the purposes of subsection 6-5(2) of the ITAA 1997.

25. Subsection 6-15(2) of the ITAA 1997 provides that if an amount is exempt income then it is not assessable income.

26. Section 11-15 of the ITAA 1997 lists those provisions dealing with income which may be exempt. Included in this list is section 23AG of the ITAA 1936 which deals with exempt foreign employment income.

27. Section 23AG of the ITAA 1936 provides a general exemption from income tax on the foreign earnings derived from foreign service by an Australian resident taxpayer who has been engaged in that foreign service continuously for 91 days or more.

28. Subsection 23AG(1) states:

Where a resident, being a natural person, has been engaged in foreign service for a continuous period of not less than 91 days, any foreign earnings derived by the person from that foreign service is exempt from tax.

29. The basic tests for the exemption of foreign employment income in subsection 23AG(1) are:

- the taxpayer must be a 'resident of Australia';
- the taxpayer must be engaged in 'foreign service';
- the foreign service must be for a continuous period of not less than 91 days; and
- the taxpayer must derive 'foreign earnings' from that 'foreign service'.

However, in certain circumstances foreign earnings that meet these tests may not be exempt (see paragraphs 55 to 59).

Resident of Australia

30. The determination of a person's residency status depends on that person's circumstances and is a determination made in relation to each year of income. For further information see Income Tax Ruling IT 2650. This Class Ruling only applies to the class of persons described in paragraph 3 who remain Australian residents for tax purposes during their deployment to the Solomon Islands.

31. This Ruling is based on the assumption that the APS employees deployed to the Solomon Islands as part of RAMSI will remain residents of Australia for tax purposes throughout the period of their deployment.

Engaged in foreign service

32. 'Foreign service' is defined as 'service in a foreign country as a holder of an office or in the capacity of an employee' (subsection 23AG(7)).

33. The term 'employee' is defined within subsection 23AG(7) to include 'a person employed by a government or an authority of a government or by an international organisation'.

34. The APS employees referred to in paragraph 3 of this Ruling are considered to meet the above definition of an 'employee'.

35. The deployment of employees to the Solomon Islands constitutes 'foreign service' as the employees are undertaking 'service in a foreign country as a holder of an office or in the capacity of an employee'.

Continuous period of not less than 91 days

36. Each APS employee based in the Solomon Islands is expected to serve continuously in the Solomon Islands for a period of at least 91 days. These periods of 'foreign service', if met, satisfy the test that Australian residents working overseas must be engaged 'for a continuous period of not less than 91 days'.

37. Should an employee depart the Solomon Islands prior to the completion of 91 days of continuous service, that employee will normally be ineligible for the exemption.

38. In certain instances, an employee who departs the Solomon Islands prior to serving the necessary number of days, may still qualify for exemption if they return to continue their posting at a later date (refer paragraphs 9 to 16 of Taxation Ruling TR 96/15).

Temporary absences

39. Subsection 23AG(6) provides that temporary absences from foreign service form part of the period of foreign service. The Commissioner's view on the application of that subsection is reflected in paragraphs 9 to 11 of TR 96/15.

40. This includes absences on recreation leave, other than:

- leave wholly or partly attributable to a period of service or employment other than the foreign service;
- long service leave, furlough, extended leave or leave of a similar kind (however described); or
- leave without pay or on reduced pay.

41. Where an APS employee is temporarily absent from foreign service due to an absence on recreation leave included in the previous paragraph, these absences will be taken to form part of the period of foreign service.

42. In respect of periods spent by employees who return to Australia in exceptional circumstances as described in paragraph 20, these periods are temporary absences from duty authorised by the terms and conditions of the employee's foreign service and are taken to form part of the employee's foreign service period. As such, these absences will not break the continuity of eligible foreign service.

43. If an employee who returned to Australia in exceptional circumstances as described in paragraph 20 of this Ruling, extends their stay to take recreational leave that accrued wholly from foreign service in the Solomon Islands, that period of leave is taken to form part of the employee's foreign service.

Temporary absences utilising leave entitlements from employment in Australia

44. As advised in paragraph 5 of this Ruling, APS employees who take leave that accrued wholly or partly from employment in Australia are not part of the class of person to whom this Ruling applies.

45. In certain limited circumstances, an employee who is temporarily absent from the Solomon Islands while taking a period of leave that had accrued wholly or partly from employment in Australia may still meet the requirements of continuous service for exemption under section 23AG. Employees who have or are planning to take leave using an entitlement that wholly or partially accrued from employment in Australia should seek professional advice from their taxation adviser or the Australian Taxation Office about the application of subsection 23AG(6D) to their circumstances.

Foreign earnings

46. The definition of 'foreign earnings' is also contained in subsection 23AG(7), which provides that:

'foreign earnings' means income consisting of earnings, salary, wages, commission, bonuses or allowances but does not include any payment, consideration or amount that:

- (a) is included in assessable income under Subdivision AA of Division 2; or
- (b) is excluded from the definition of **'eligible termination payment'** in subsection 27A(1) because of paragraph (ja), (k), (ka), (m), (ma), (n) or (p) of that definition.

47. The exclusions to the definition of 'foreign earnings' at paragraphs (a) and (b) above are not relevant to this arrangement as they relate to pensions, annuities, eligible termination payments and other similar amounts.

48. The remuneration of deployed APS employees takes the form of an annual salary entitlement and the payment of various allowances (see paragraphs 16 and 17 of this Ruling).

49. The salary and allowances described in paragraphs 16 and 17 of this Ruling, with the exception of the transfer allowance, come within the definition of 'foreign earnings' in subsection 23AG(7).

50. Whilst the salary of employees may be paid into financial institutions in Australia, those 'earnings' are still considered 'foreign earnings'.

From that foreign service

51. To qualify for the exemption the 'foreign earnings' must be derived from that 'foreign service'. That does not mean that the foreign earnings need to be derived at the time of engaging in foreign service. The important test is that the foreign earnings, when derived, need to be derived as a result of the undertaking of that foreign service.

52. In the case of allowances paid after a person returns to Australia that relate to the period of foreign service, such allowances are treated as foreign earnings derived from that foreign service. Also, any advances against salary or allowances paid to a taxpayer prior to the undertaking of foreign service arising from the undertaking of that foreign service would be treated as foreign earnings from foreign service.

53. The salary that is paid when taking recreation leave that accrued during the period of foreign service is also considered to be foreign earnings from that foreign service, even though the recreation leave may be taken after the completion of the foreign service.

54. APS employees referred to in paragraph 3 of this Ruling are also entitled to a transfer allowance prior to engaging in foreign service and after the completion of foreign service. The transfer allowance, which is payable prior to the deployment period and after the end of the foreign service is not derived from that foreign service. It is paid as a compensation for non-reimbursed expenditure incurred prior to engaging in foreign service and after completion of foreign service and therefore does not qualify for exemption under section 23AG.

Foreign earnings which are not exempt

55. Subsection 23AG(2) of the ITAA 1936 provides that no exemption is available under subsection 23AG(1) in circumstances where an amount of foreign earnings derived from service in a foreign country is exempt from tax in the foreign country solely because of:

- a double tax agreement or a law of a country that gives effect to such an agreement (paragraphs 23AG(2)(a) and (b));
- the law of a foreign country generally exempts from, or does not provide for the imposition of income tax on income derived in the capacity of an employee, income from personal services or any other similar income (paragraphs 23AG(2)(c) and (d)); or
- a law or international agreement dealing with privileges and immunities of diplomats or consuls or of persons connected with international organisations applies (paragraphs 23AG(2)(e), (f) and (g)).

56. There is currently no double taxation agreement between Australia and the Solomon Islands.

57. The privileges and immunities of persons connected with an international organisation do not apply to the situation in the Solomon Islands.

58. The foreign earnings derived by the APS employees in the Solomon Islands are not exempt, under a general provision, from income tax in the Solomon Islands.

59. Article 16.6 of the RAMSI Agreement and the *Facilitation of International Assistance Act 2003* provide that personnel deployed to Solomon Islands as part of RAMSI shall be exempt from taxation by the Solomon Islands government on their pay and other emoluments. Accordingly, the foreign earnings of APS employees will be exempt in the Solomon Islands for a reason other than those listed in subsection 23AG(2). Therefore, subsection 23AG(2) will not apply to deny the exemption under subsection 23AG(1).

Exemption with progression

60. The 'foreign earnings' of employees that are exempt from Australian tax under section 23AG are nevertheless taken into account in calculating the Australian tax on other assessable income derived by the employee (subsection 23AG(3)).

61. Tax on other assessable income will be calculated by applying to the non-exempt income (for example, Australian salary, investment income), the notional average rate of tax payable on the sum of exempt income and non-exempt income.

62. Any deductions that relate to the exempt income are allowed as if the exempt income was assessable income. That is, expenses which relate directly to earning income in the Solomon Islands are deductible from exempt income.

Example

63. In the 2004-2005 income year, Michael, an APS employee derived the following types of income:

- Australian employment income of \$60,300;
- allowable deductions against Australian income of \$300;
- foreign exempt employment income of \$30,100; and
- expenses directly related to foreign exempt employment income of \$100.

Assume that the employee has appropriate private patient hospital cover for Medicare levy surcharge purposes.

The total amount of Australian tax payable will be calculated with reference to the following formula:

$(\text{Notional gross tax} / \text{Notional gross taxable income}) \times \text{Other taxable income}$

Step 1

The employee's **notional gross taxable income** is \$90,000 $([\$60,300 - \$300] + [\$30,100 - \$100])$.

Step 2

The **notional gross tax** is \$29,362 (the normal Australian income tax and Medicare levy payable on a taxable income of \$90,000).

Step 3

The **other taxable income** is \$60,000 (Australian employment income).

Step 4

The Australian tax payable (including Medicare levy) on the employee's Australian income is:

$$(\$29,362/\$90,000) \times \$60,000 = \$19,574.67$$

Detailed contents list

64. Below is a detailed contents list for this Class Ruling:

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; CR 2003/94;
CR 2004/129; CR 2005/25;
TR 92/1; TR 92/20; TR 96/15;
TR 97/16; IT 2650

Subject references:

- exempt foreign income
- exempt income
- foreign exempt employment income
- foreign income
- foreign salary & wages
- foreign source income
- international tax
- Solomon Islands
- overseas countries
- overseas tax laws
- residence of individuals

Legislative references:

- Copyright Act 1968
- TAA 1953 Pt IVA
- ITAA 1936 23AG
- ITAA 1936 23AG(1)

- ITAA 1936 23AG(2)
- ITAA 1936 23AG(2)(a)
- ITAA 1936 23AG(2)(b)
- ITAA 1936 23AG(2)(c)
- ITAA 1936 23AG(2)(d)
- ITAA 1936 23AG(2)(e)
- ITAA 1936 23AG(2)(f)
- ITAA 1936 23AG(2)(g)
- ITAA 1936 23AG(3)
- ITAA 1936 23AG(6)
- ITAA 1936 23AG(6D)
- ITAA 1936 23AG(7)
- ITAA 1936 Pt III Div 2 Subdiv AA
- ITAA 1936 27A(1)
- ITAA 1997 6-5
- ITAA 1997 6-5(2)
- ITAA 1997 6-15(2)
- ITAA 1997 11-15
- Facilitation of International Assistance Act 2003 (Solomon Islands)

Other references:

- Treaty Agreement between the Australian Government and the Solomon Islands Government covering the RAMSI deployments

ATO references

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