IT 2574 - Income tax: Australia/United States Double Taxation Convention: Exchange Teachers

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TAXATION RULING NO. IT 2574

INCOME TAX : AUSTRALIA/UNITED STATES DOUBLE TAXATION CONVENTION: EXCHANGE TEACHERS

F.O.I. EMBARGO: May be released

REF N.O. REF: 87/10859-7 DATE OF EFFECT: Immediate
89/7894-8
B.O. REF: DATE ORIG. MEMO ISSUED: 9 March 1988

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1011767	EXEMPT INCOME TEACHERS AND PROFESSORS AUSTRALIA/UNITED STATES DOUBLE TAXATION CONVENTION	23(q), 23AG INCOME TAX (INTERNATIONAL AGREEMENTS) ACT: SCHEDULE 2 ARTICLES 15, 19

OTHER RULINGS ON TOPIC:

PREAMBLE The purpose of this ruling is to clarify the Australian taxation liabilities of Australian and United States teachers participating in teacher exchange programs where those teachers continue to be paid by an education authority in their country of residence. The Ruling does not apply to Australian teachers paid by a US educational authority or US teachers paid by an Australian educational authority.

2. The position of Australian teachers employed by the Commonwealth or a State or Territory Government who travel to the United States for periods of approximately 12 months to work in US schools under various exchange programs was recently considered by this office. Since the Australia/United States Double Taxation Convention (the Convention) does not contain a specific Article dealing with the taxation liabilities of visiting teachers, the question arose whether the teaching income derived by such teachers while on exchange should be treated in accordance with Article 19 (Governmental Remuneration) or whether Article 15 (Dependent Personal Services) applied.

3. Article 19 exempts from income tax in the country visited remuneration paid to a government employee who is a citizen of the paying country and who discharges governmental functions in the country visited.

4. Article 15 applies in other cases of paid employment and states a general rule that remuneration derived by an employee who is a resident of one country will be taxable only in that country unless the employment is exercised in the other country. This general rule is subject to paragraph (2) of Article 15 which has the effect that, where the exchange teacher is present

in the other country for a period or periods not exceeding 183 days in the year of income of that country, the remuneration is taxable only in the country of residence and not where the employment is exercised. In this regard, it should be noted that the US taxable year runs from 1 January to 31 December.

RULING

5. It has been decided that an Australian teacher working in a US school under an exchange program should not be regarded as discharging governmental functions on behalf of the Commonwealth or a State or Territory Government while performing general teaching duties in the US school, notwithstanding that the teacher is paid by a Commonwealth, State or Territory Government education authority. Similarly, a US exchange teacher working in an Australian school will not be regarded as discharging governmental functions while performing general teaching duties in Australia. It follows that Article 19 will have no application to government-employed exchange teachers. The provisions of Article 15 will apply to government and non-government teachers alike.

6. The Internal Revenue Service has advised that, as a general rule, the United States would not view teaching as an activity which constitutes the discharge of governmental functions. Accordingly, Article 19 would not be applied to exempt a government teacher's salary from taxation in the United States. It was confirmed that Article 15 would apply and that in the normal course of events Australian teachers teaching in the United States for a period exceeding 183 days during a US taxable year will be liable to tax in the United States on the salary applicable to the teaching services performed in the United States during that time.

7. This treatment also accords with the practice adopted in other Double Taxation Conventions where no specific Professor and Teacher Article has been included in the Convention or where the Article is found not to apply because of specific circumstances. In these cases, the Article dealing with Dependent Personal Services has been relied upon to allocate the taxing rights between the respective countries. It is considered appropriate to adopt the same approach in relation to Australian and US teachers.

8. US exchange teachers who are present in Australia for 183 days or less of a year of income will be taxable only in the United States on their teaching income under Article 15 of the Convention. However, where the period or periods in Australia exceed in total 183 days of the Australian year of income, the remuneration will be taxed in Australia at the rates of tax applicable to non-residents.

9. Where an Australian teacher is present in the United States for 183 days or less of a US taxable year, Article 15 of the Convention provides that the remuneration paid will be taxable only in Australia. In these circumstances, the Australian employer should continue to deduct tax instalments from the teacher's salary at the usual rates prior to its remittance overseas.

10. The remuneration of Australian teachers who are present in the United States for more than 183 days of the US taxable year will ordinarily be subject to taxation in the United States. Where it is taxed in the United States, the remuneration will generally be partly or wholly exempt from Australian tax. In these circumstances an application under section 221D for variation of tax instalment deductions may be made.

11. For the year of income ended 30 June 1987 and prior income years, income will be exempt from Australian tax under paragraph 23(q) of the Income Tax Assessment Act 1936 where it is shown that income tax has been or will be paid in the United States on the teacher's remuneration.

12. When the foreign tax credit system was introduced to apply income of the 1987/88 and subsequent years of income, paragraph 23(q) was repealed and section 23AG was enacted to specifically cover income earned by employees performing services in a foreign country. An explanation of the operation of section 23AG can be found in Taxation Rulings IT 2441 and 2563. However, some specific points about how it applies to Australians teaching in the United States can be noted.

13. Subsection 23AG(1) exempts the full amount of teaching salary from Australian tax where a continuous period of employment in the United States is not less than 365 days, provided the salary is subject to income tax in the United States and the taxpayer is able to demonstrate that the US tax has been or will be paid. For purposes of determining the period of foreign service, the period will be taken to commence on the date when the teacher commences teaching duties in the United States. The period of foreign service will include recreation leave or school holidays attributable to the US teaching activities, whether taken in the United States or Australia or elsewhere.

14. A proportionate exemption is conferred by subsection 23AG(2) where a continuous period of foreign service is less than 365 days but not less than 91 days. In the present context, subsection 23AG(2) must be read in conjunction with Article 15 of the Convention which provides that Australia has sole taxing rights where the Australian teacher is in the United States for 183 days or less of the US taxable year. Examples showing the operation of subsection 23AG(2) in cases where both Australia and the United States have retained taxing rights are set out at paragraph 19.

15. Where, as a result of an application of subsection 23AG(2), part of an Australian teacher's salary is taxable in Australia and part is exempt, the Australian income tax is calculated in accordance with subsection 23AG(4). The effect of that subsection is that the part subject to tax in Australia bears tax at the taxpayer's marginal rate as if that part were the "top slice" of the taxpayer's assessable income. Where the total salary earned between 1 July and 30 June inclusive is, say, $30,000 of which, say, $25,000 is exempt under subsection

23AG(2), the Australian tax payable on the remaining $5,000 is ascertained by first calculating the tax at normal rates on the full $30,000 and then deducting the tax at normal rates on the $25,000.

16. It needs to be remembered that subsection 23AG(6H) has the effect that where the application of the general foreign tax credit system would result in a lesser amount of Australian tax payable than would be payable under the formula in subsection 23AG(4), section 23AG will not apply. The result is that the foreign earnings will be taxed in accordance with the general foreign tax credit system.

17. From the 1987/88 year of income salary derived in the United States that is not exempt from Australian tax is subject to the foreign tax credit system. A foreign tax credit against the Australian tax payable will be allowed for US income tax paid on that part of the remuneration derived from teaching in the United States that is not exempt under section 23AG. In calculating the allowable foreign tax credit, the US tax paid on the whole of the US earnings will be pro-rated according to the proportion of non-exempt to exempt income. For example, if 30% of the US remuneration is non-exempt, 30% of the US tax paid will be allowable as a credit against the Australian tax, subject to a maximum credit of an amount equal to the amount of Australian income tax on the part of the foreign income subject to Australian tax.

18. Where a claim is made for a foreign tax credit, a taxpayer must be able to show that the foreign tax has, in fact, been paid. The type of documentary evidence necessary for these purposes is set out in paragraphs 42 to 57 of Taxation Ruling No. IT 2527. As explained in paragraph 46 of that Ruling, it will be sufficient for teachers to supply a copy of their US income tax return accompanied by a receipt verifying that the US tax as calculated on the basis of the return has been paid. Alternatively, a statement from the Internal Revenue Service, or the IRS representative attached to the American Embassy in Australia, stating that U.S. taxes have been paid by the taxpayer and showing the amount of such tax, would be acceptable.

19. The following examples illustrate the tax liabilities of an Australian teacher in respect of remuneration derived from teaching in the United States.

A. PRESENT IN THE US FOR 183 DAYS OR LESS OF A US TAXABLE YEAR

- Not taxed in United States
- Fully taxable in Australia

Example

Teacher on exchange to United States from 1 August 1988 to 31 May 1989. Bearing in mind that the US taxable year runs from 1 January to 31 December inclusive, this represents a stay of 153 days in the 1988 US taxable year and 151 days in the 1989 US

taxable year. As the taxpayer is not present in the United States for more than 183 days of either the 1988 or 1989 US taxable year, the income is taxable only in Australia by virtue of Article 15 of the Convention. No exemption from Australian tax is available under section 23AG because the income is not subject to US tax.

B. PRESENT IN THE US FOR MORE THAN 183 DAYS OF A US TAXABLE YEAR

i) If not less than 365 days continuous foreign service:
- Taxable in United States
- Exempt in Australia under paragraph 23(q) (if derived prior to the 1987/88 income year) or section 23AG (if derived in the 1987/88 and subsequent years).

Example

Teacher on exchange to United States from 1 December 1988 to 20 December 1989. For 1988 US taxable year, taxpayer has not been present in the United States for more than 183 days of that taxable year. The income earned between 1 December 1988 and 31 December 1988 is taxable only in Australia under Article 15 of the Convention. The taxpayer is present in the United States for the majority of the 1989 US taxable year, so the income derived in that tax year is taxable in the United States. Taxpayer has been engaged in foreign service for a continuous period in excess of 365 days, so the income for the period 1 January 1989 to 20 December 1989 inclusive is exempt from Australian tax under sub section 23AG(1).

ii) If more than 183 days of US taxable year but less than 365 days continuous foreign service:

- Taxable in United States
- Fully exempt in Australia if salary derived prior to the 1987/88 income year (paragraph 23(q))
- If derived in the 1987/88 or subsequent years part only of the salary is subject to Australian tax (subsection 23AG(2)) and a proportional amount of the US tax paid is allowable as a foreign tax credit (subsections 160AF(1) and (6)).

Example 1

Teacher on exchange in United States from 1 July 1986 to 31 January 1987. Taxpayer is present in United States for more than 183 days of the 1986 US taxable year. The income derived between 1 July 1986 and 31 December 1986 is taxable in the United States and exempt in Australia (paragraph 23(q)). Taxpayer is only present in the United States for 31 days of the 1987 US taxable year so under Article 15 of the Convention the income derived in that period is taxable only in Australia.

Example 2

Teacher on exchange in United States from 1 February 1989 to 30 November 1989. Taxpayer is present in the United States for

more than 183 days of the 1989 US taxable year, so the income is taxable in the United States under Article 15. Taxpayer is engaged in foreign service for a continuous period of 303 days. Thus for the Australian year of income ended 30 June 1989, 303/365ths of the US income derived in that year of income will be exempt from Australian tax under subsection 23AG(2). Similarly, in the year of income ended 30 June 1990 303/365ths of the US remuneration earned during the period 1 July 1989 to 30 November 1989 inclusive will be exempt.
The remainder of the remuneration (i.e. 62/365ths) in both income years will be assessable in Australia. However, a foreign tax credit will be allowable against the Australian tax payable on the non-exempt portion (i.e. 62/365ths) of the US remuneration. The US tax paid would first need to be apportioned between the 1989 and 1990 income years on the basis of the US salary derived between 1 February 1989 and 30 June 1989 (inclusive) and the US salary derived between 1 July 1989 and 30 November 1989 (inclusive). Of the resulting amounts, 62/365ths would be allowable as foreign tax credits in the respective Australian income years.

COMMISSIONER OF TAXATION
25 January 1990