



Class Ruling

Income tax: assessable income: Australian Federal Police personnel deployed to Vanuatu as part of the Development Cooperation Project

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	12
Scheme	16
Ruling	30
NOT LEGALLY BINDING SECTION	
Appendix 1:	
Explanation	34
Appendix 2:	
Detailed contents list	81

❶ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions 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 entities

3. The class of entities to which this Ruling applies are:

- Australian Federal Police (AFP) officers;
- persons seconded to the AFP under section 69D of the *Australian Federal Police Act 1979* (AFP Act 1979) for the period of deployment; and

- persons appointed to the AFP as special members of the AFP under section 40E of the AFP Act 1979 for the period of their deployment,

who are deployed to Vanuatu under the Memorandum of Understanding between the Government of Australia and the Government of Vanuatu as part of the Development Cooperation Project (the Project). The deployment under the Project will support the Government of Vanuatu's short to medium goal of long-term stability.

4. Those deployed as described in paragraph 3 of this Ruling to whom this Ruling applies will be collectively referred to in this Ruling as AFP employees.

5. AFP employees remain Australian residents throughout the period of deployment.

6. AFP employees include employees who while on deployment to Vanuatu return to Australia for a period during which they utilise leave that has wholly accrued from their service in Vanuatu.

7. The class of entities does not include AFP employees:

- who while on deployment to Vanuatu return to Australia for a period during which they utilise leave that has wholly or partly accrued from service in Australia; or
- deployed on a short-term basis for a period of 4 to 8 weeks at a time.

Qualifications

8. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 29 of this Ruling.

10. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

11. This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Attorney General's Department
Robert Garran Offices
National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

Date of effect

12. This Ruling applies from 1 February 2006. However, this 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 this Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

13. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

14. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

15. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

16. The scheme that is the subject of the Ruling is described below. This description is based on the following documents which are attached to the file record maintained by the Australian Taxation Office for this Ruling. 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 scheme are:

- the application for Class Ruling (dated 2 February 2006);
- AFP – International Deployment Group (IDG) – Determination No 20 of 2005;
- Subsidiary Arrangement between the Government of Australia and the Government of Vanuatu Relating to an Integrated Law and Justice Framework for Vanuatu (signed 23 December 2005);
- Memorandum of Understanding between the Government of Australia and the Government of Vanuatu on Development Cooperation (the Government Treaty) (signed 17 December 2005); and
- AFP Certified Agreement 2003-2006 (Certified Agreement).

17. In December 2005, the Australian Government announced an ongoing program of capacity building assistance for the law and justice sector of Vanuatu.

18. The AFP's core function will be to work with the Vanuatu's law and justice sector to achieve a more professional, accountable and community-orientated police force.

19. The AFP employees will be deployed to Vanuatu for a two year posting, with an option to extend for a further year. AFP employees have an option of deploying to Vanuatu accompanied by their families.

20. The AFP employees will not be afforded diplomatic status and will not be attached to a diplomatic mission.

21. The remuneration for AFP employees takes the form of an annual salary entitlement and the payment of various allowances. Salary and allowances will continue to be paid into the employee's nominated account on a fortnightly basis.

22. The AFP employees will be entitled to some or all of the following allowances:

- composite overseas allowance;
- transfer allowance (pre-departure);
- location allowance;

- extended overseas unaccompanied allowance;
 - communication allowance;
 - boarding allowance (if applicable); and
 - transfer allowance (repatriation).
23. Allowances will be paid while an AFP employee is on leave accrued during the deployment period.
24. The AFP employees are entitled to the following categories of leave:
- standard recreation leave;
 - personal leave;
 - miscellaneous leave with pay; and
 - miscellaneous leave without pay.
25. During the period of deployment, AFP employees entitlement to recreation leave and mandatory recreation leave are prescribed under the AFP Certified Agreement.
26. AFP employees accrue 240 hours recreation leave per annum on a monthly pro-rata basis. Recreation leave is credited to the employee on the first day of each month.
27. The employee's team leader may approve recreation leave subject to operational requirements and the employee's leave balance.
28. In addition to standard recreation leave employees will accrue a further 5 days off per annum on the basis of one day for two months worked. This mandatory recreation leave will be taken in accordance with arrangements made with the Team Leader, and cannot be taken as other than single days unless otherwise agreed by a General Manager.
29. Paragraph 10.1 of the Government Treaty grants an exemption to members of the Australian project personnel from taxation (including AFP employees deployed as part of the project) by the Government of Vanuatu on their salaries and other allowances.

Ruling

30. Subject to paragraph 31 of this Ruling, the salary and allowances referred to in paragraphs 21 and 22 of this Ruling, derived by AFP employees described in paragraphs 3 to 6 of this Ruling deployed to Vanuatu are exempt from tax under section 23AG of the ITAA 1936 where:
- the employee has been engaged, or is taken to have been engaged, in service in Vanuatu for a continuous period of not less than 91 days; and

- the salary and allowances are derived from that foreign service, including payments for recreation leave that has wholly accrued from the period of service in Vanuatu.

31. The transfer allowance (pre-departure) and transfer allowance (repatriation) referred to in paragraph 22 of this Ruling are not exempt from tax under subsection 23AG(1) of the ITAA 1936.

32. Where the salary and allowances are exempt from tax under paragraph 30 of this Ruling, they are 'foreign earnings' of the AFP employees under subsection 23AG(7) of the ITAA 1936 and are taken into account in calculating the Australian tax on other assessable income derived by the employee (subsection 23AG(3) of the ITAA 1936).

Example

33. In the 2005-2006 income year, Daniel, an AFP employee derives the following types of income:

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

Assume that Daniel 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:

(Notional gross tax/Notional gross taxable income) × Other taxable income

Step 1

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

Step 2

The **notional gross tax** is \$27,450 (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 Daniel's Australian income is:

$$(\$27,450/\$90,000) \times \$60,000 = \$18,300$$

Commissioner of Taxation21 June 2006

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

34. 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.

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

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

37. 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.

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

39. Subsection 23AG(1) of the ITAA 1936 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.

40. The basic tests for the exemption of foreign employment income in subsection 23AG(1) of the ITAA 1936 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, certain foreign earnings that meet these tests may not be exempt from tax (see paragraphs 71 to 77 of this Ruling).

Resident of Australia

41. 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 Taxation Ruling IT 2650. This Ruling only applies to the class of entities described in paragraphs 3 to 6 of this Ruling who remain Australian residents for tax purposes during their deployment to Vanuatu.

42. This Ruling is based on the assumption that AFP employees deployed to Vanuatu will remain Australian residents for tax purposes throughout the period of their deployment.

Engaged in foreign service

43. 'Foreign service' is defined as 'service in a foreign country as the holder of an office or in the capacity of an employee' (subsection 23AG(7) of the ITAA 1936).

44. The term 'employee' is defined within subsection 23AG(7) of the ITAA 1936 to include 'a person employed by a government or an authority of a government or by an international organisation'.

45. AFP employees referred to in paragraphs 3 to 6 of this Ruling are considered to meet the above definition of an 'employee'.

46. Deployment of AFP employees to Vanuatu constitutes 'foreign service' as each employee is undertaking 'service in a foreign country as a holder of an office or in the capacity of an employee'.

For a continuous period of not less than 91 days

47. Each AFP employee based in Vanuatu is expected to serve continuously in Vanuatu 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 in foreign service 'for a continuous period of not less than 91 days'.

48. Should an AFP employee depart Vanuatu prior to the completion of 91 days of continuous service, that employee will normally be ineligible for the exemption.

49. However, in certain instances, an employee who departs Vanuatu 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 forming part of a period of foreign service

50. Subsection 23AG(6) of the ITAA 1936 treats certain temporary absences from foreign service as forming 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.

51. Absences which form part of the period of foreign service include absences taken in accordance with the terms and conditions of employment because of accident or illness or recreation leave, other than:

- a) leave wholly or partly attributable to a period of service or employment other than the foreign service;

- b) long service leave, furlough, extended leave or leave of a similar kind (however described); or
- c) leave without pay or on reduced pay.

52. A period in which an employee is absent on extended leave (see paragraph 51(b) of this Ruling) is not a period of 'foreign service' for the purposes of subsection 23AG(1) of the ITAA 1936. Additional recreation leave entitlements granted to employees posted overseas will not be considered to constitute extended leave where the additional leave is reasonable.

53. Given the nature of the overseas deployment, it is considered that the recreation leave granted to AFP employees deployed to Vanuatu is reasonable. Therefore, the period of recreation leave will form part of a continuous period of 'foreign service' for the purposes of subsection 23AG(1) of the ITAA 1936.

54. Miscellaneous leave with pay and personal leave granted to the AFP employee because of the accident, illness or death of another person will also form part of the employee's period of continuous foreign service where the leave is for a short period. Miscellaneous leave without pay will not form part of the period of foreign service.

Temporary absences not breaking the period of foreign service: the one-sixth administrative test

55. In certain limited circumstances, breaks other than those specified in paragraph 51 of this ruling are also taken to form part of a period of foreign service. Such breaks include weekends, public holidays, rostered days off, and days off in lieu of such, where such breaks are authorised by the terms and conditions of the deployment. However, where such breaks are used to return to Australia they must not be excessive. Where the break is excessive the period of foreign service will still not be broken if continuity of the foreign service period can be maintained by application of the rules outlined in paragraph 57 of this Ruling.

56. Breaks taken to visit or return to Australia are considered excessive when the total of such breaks are more than one-sixth of the period of scheduled foreign service or, if the period of foreign service is ongoing, more than one-sixth of the income year. This one-sixth administrative test is different to the 1/6 legislative rule covered in paragraphs 58 to 60 of this Ruling.

Temporary absences not breaking the period of foreign service: the legislative rule

57. In determining whether the continuity of foreign service can be maintained, the AFP employee should consider the application of subsection 23AG(6A) of the ITAA 1936. Paragraphs 58 to 60 of this Ruling provide an explanation of this tax provision. Alternatively, the AFP employee could seek professional advice from their taxation adviser or the Australian Taxation Office.

Continuity of the period of foreign service: 1/6 legislative rule

58. The 1/6 legislative rule allows two or more continuous periods of foreign service to be joined as a total period of foreign service, unless, at any time, the total period of absence (in days) from foreign service between the continuous periods of foreign service exceeds 1/6 of the number of days of the total period of foreign service.

59. If the period of absence exceeds 1/6 of the total period of foreign service at any time, continuity of foreign service is broken. The AFP employee will begin a new period of foreign service when he or she next engages in foreign service and must determine whether that period of foreign service lasts for at least 91 continuous days (subsections 23AG(6A) of the ITAA 1936).

60. The 1/6 legislative rule should not be confused with the one-sixth administrative test outlined at paragraphs 55 and 56 of this Ruling. The 1/6 legislative rule in subsection 23AG(6A) permits two or more periods of foreign service to constitute a continuous period of foreign service where continuity would be otherwise broken by absence. Absences between the periods of foreign service under the 1/6 legislative rule do not form part of the continuous period of foreign service. In contrast, the one-sixth rule is an administrative test which permits what would otherwise be a break in the foreign service to be included in a continuous period of foreign service.

Foreign earnings

61. The definition of 'foreign earnings' is contained in subsection 23AG(7) of the ITAA 1936, which provides that:

foreign earnings means income consisting of earnings, salary, wages, commission, bonuses or allowances, or of amounts included in a person's assessable income under Division 13A, 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.

62. The exclusions to the definition of 'foreign earnings' in paragraph 60 of this Ruling are not, however, relevant to this arrangement as they relate to pensions, annuities, eligible termination payments and other similar amounts.

63. The remuneration of deployed AFP employees takes the form of an annual salary entitlement and the payment of various allowances.

64. These salary and allowances which are described in paragraphs 21 and 22 of this Ruling, with the exception of the travel allowance (pre-departure) and travel allowance (repatriation), come within the definition of 'foreign earnings' in subsection 23AG(7) of the ITAA 1936.

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

From that foreign service

66. To qualify for the exemption the 'foreign earnings' must be derived from the '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.

67. In the case of allowances paid after the taxpayer 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 the 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.

68. The receipt of the following allowances:

- a) composite overseas allowance;
- b) location allowance;
- c) extended overseas unaccompanied allowance;
- d) communication allowance;
- e) boarding allowance (if applicable),

are considered to be foreign earnings from the foreign service as they relate to engaging in foreign service in Vanuatu.

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

70. An AFP employee is also entitled to a transfer allowance (pre-departure) prior to engaging in foreign service and a transfer allowance (repatriation) after the completion of foreign service. The transfer allowance payable prior to the deployment period and after the end of the foreign service is not foreign earnings derived from that foreign service. It is paid as a compensation for non-reimbursed expenditure incurred by the AFP employee prior to engaging in foreign service and after completion of foreign service and does not, therefore, qualify for exemption under section 23AG of the ITAA 1936.

Certain foreign earnings not exempt

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

- a) a double tax agreement or a law of a country that gives effect to such an agreement (paragraphs 23AG(2)(a) and (b));
- b) a law of that foreign country which 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)); and
- c) a law or international agreement dealing with privileges and immunities of diplomats or consuls or of persons connected with international organisations (paragraphs 23AG(2)(e), (f) and (g)).

72. There is currently no tax treaty between Australia and Vanuatu.

73. The privileges and immunities of persons connected with an international organisation do not apply to AFP employees working in Vanuatu.

74. The foreign earnings derived by AFP employees in Vanuatu are not subject to income tax as the law of Vanuatu does not provide for the imposition of income tax on any of the categories of income listed at paragraphs 21 and 22 of this Ruling. Therefore, the income would not be exempt from tax under subsection 23AG(1) of the ITAA 1936 because paragraph 23AG(2)(d) of the ITAA 1936 applies.

75. Consequently, unless the income is also exempt from taxation in Vanuatu for another reason that is not listed in subsection 23AG(2) of the ITAA 1936, the income will not be exempt in Australia under the provisions of subsection 23AG(1) of the ITAA 1936.

76. Paragraph 10.1 of the Government Treaty exempts members of the Australian project personnel (including AFP employees deployed as part of the project) from taxation on their salaries and other allowances.

77. As a result, the foreign earnings of the deployed AFP employees are not exempt from tax in Vanuatu solely because of any of the reasons listed in subsection 23AG(2) of the ITAA 1936. Therefore, subsection 23AG(2) will not operate to deny the exemption under subsection 23AG(1) of the ITAA 1936.

Exemption with progression

78. The 'foreign earnings' of AFP employees that are exempt from Australian tax under section 23AG of the ITAA 1936 are nevertheless taken into account in calculating the Australian tax on other assessable income derived by the employee (subsection 23AG(3) of the ITAA 1936).

79. 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.

80. In calculating these amounts, 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 Vanuatu are deductible from exempt income.

Appendix 2 – Detailed contents list

81. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	8
Date of effect	12
Scheme	16
Ruling	30
Example	33
Appendix 1 – Explanation	34
Resident of Australia	41
Engaged in foreign service	43
For a continuous period of not less than 91 days	47
Temporary absences forming part of a period of foreign service	50
Temporary absences not breaking the period of foreign service: the one-sixth administrative test	55
Temporary absences not breaking the period of foreign service: the legislative rule	57
Continuity of the period of foreign service: 1/6 legislative rule	58
Foreign earnings	61
From that foreign service	66
Certain foreign earnings not exempt	71
Exemption with progression	78
Appendix 2 – Detailed contents list	81

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 96/15; IT 2650

Subject references:

- exempt foreign income
- exempt income
- foreign exempt employment income
- foreign income
- foreign income deductions
- foreign salary & wages
- foreign source income
- international tax
- overseas countries
- overseas employees
- overseas tax laws
- residence of individuals
- Vanuatu

Legislative references:

- 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(6A)
- ITAA 1936 23AG(7)
- ITAA 1936 Pt III Div 2 Subdiv AA
- ITAA 1936 27A(1)
- ITAA 1936 Pt III Div 13A
- ITAA 1997 6-5
- ITAA 1997 6-5(2)
- ITAA 1997 6-15(2)
- ITAA 1997 11-15
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- AFP Act 1979 40E
- AFP Act 1979 69D

Other references:

- Memorandum of Understanding between the Government of Australia and the Government of Vanuatu on Development Cooperation
- Subsidiary Arrangement between the Government of Australia and the Government of Vanuatu Relating to an Integrated Law and Justice Framework for Vanuatu

ATO references

NO: 2006/9471

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Exempt income ~~ allowances and benefits
Income Tax ~~ Exempt income ~~ employment income - foreign sourced