

CR 2003/83 - Income tax: exempt foreign employment income: Papua New Guinea Health Services Support Program (PNG HSSP) employees based in Papua New Guinea and administered by the Australian Agency for International Development (AusAID)

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2002*



Class Ruling

Income tax: exempt foreign employment income: Papua New Guinea Health Services Support Program (PNG HSSP) employees based in Papua New Guinea and administered by the Australian Agency for International Development (AusAID)

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **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' identified below applies to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law

2. The tax law dealt with in this Ruling is section 23AG of the *Income Tax Assessment Act 1936* ('ITAA 1936').

Class of persons

3. The class of persons to whom this Ruling applies are the employees of PNG HSSP posted to Papua New Guinea as part of the Papua New Guinea Health Services Support Program who are residents of Australia for taxation purposes and who are solely residents of Australia for the purposes of the Australia Papua New Guinea Double Tax Agreement ('the treaty'). The program is administered by the Australian Agency for International Development (AusAID).

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 10 to 19 is carried out in accordance with the details of the arrangement provided in this Ruling.
6. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:
 - (a) 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
 - (b) this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies from 1 July 2002. 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 Gazette;
 - it is not taken to be withdrawn by an inconsistent later public ruling; or
 - the relevant tax laws are not amended.

Withdrawal

9. This Class Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax law ruled upon, to all persons within the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

10. The arrangement that is the subject of the 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:

- The Treaty on Development Cooperation between the Government of Australia and the Government of Papua New Guinea (*dated 7 July 2000*);
- Note No 726/2000;
- Note No 270/200.

PNG Health Services Support Program

11. PNG Health Services Support Program is an AusAID funded program for which the management and implementation is currently contracted to PNG HSSP Pty Ltd. PNG HSSP Pty Ltd is a resident of Australia and is not a PNG resident. PNG HSSP Pty Ltd does not maintain a permanent establishment or a fixed base in PNG.

12. The contract for the work expires on 31 December 2004.

13. Employees are employed by PNG HSSP Pty Ltd. The PNG HSSP Fixed Term Employment Agreement and its accompanying schedules contain all the conditions of employment.

14. A number of employees have been posted, are posted or will be posted to Papua New Guinea.

15. All of the employees are employed as 'Long Term Advisers'.

16. PNG HSSP employees are required to be posted to Papua New Guinea within the period 1 July 2002 until 31 December 2004.

Employees of PNG HSSP have been posted or are expected to be posted for more than 91 days in Papua New Guinea.

17. PNG HSSP may:

- At any time direct an employee to return to Australia; and
- Repost at a later date, an employee that has returned to Australia on compassionate grounds.

If further postings are considered, an employee will not normally be considered for posting for more than 190 days within a 12 month period.

18. On posting to Papua New Guinea, PNG HSSP employees remain entitled to annual salary and other leave entitlements such as annual leave. In some cases, an advance on the salary from the posting may be payable to relevant persons.

19. In addition to a salary, employees are paid allowances for housing, utilities and security, and a living allowance. All allowances are paid monthly in arrears.

Ruling

20. Section 23AG of the ITAA 1936 provides an exemption from Australian income tax on the foreign earnings derived by an Australian resident who has been engaged in foreign service for a continuous period of not less than 91 days.

21. The exempt income from that foreign service is, however, taken into account when calculating the Australian tax payable on the assessable income of the taxpayer.

22. The salary, leave entitlements and allowances referred to in paragraphs 18 and 19 of this ruling, derived by the class of persons referred to in paragraph 3 of this ruling from their foreign service in Papua New Guinea, are exempt from tax under section 23AG where:

- those employees have been engaged in service in Papua New Guinea for a continuous period of not less than 91 days; and
- none of the conditions set out in subsection 23AG(2) are satisfied.

Explanation

23. Section 23AG 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.

24. 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.'

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

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

However, certain foreign earnings that meet these tests may not be exempt from tax (see paragraphs 39-40).

Resident of Australia

26. The determination of a person's residency status depends on their own circumstances and is a determination made in relation to each year of income. For further information, see Taxation Ruling No. IT 2650. However, this Class Ruling only applies to the class of persons who remain Australian residents for taxation purposes during the posting period in PNG and who are treated solely as a resident of Australia for the purposes of the treaty (see paragraph 3). In the majority of cases, it will be expected that persons who are posted to PNG under the PNG HSSP will satisfy the residency criteria set out in paragraph 3 of this ruling.

Engaged in foreign service

27. '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)).

28. The posting of an employee to Papua New Guinea constitutes 'foreign service' as those employees are undertaking *'service in a foreign country (Papua New Guinea) as a holder of an office or in the*

capacity of an employee. Further, 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.'

A PNG HSSP employee is considered to meet the above definition of an 'employee'.

For a continuous period of not less than 91 days

29. Each PNG HSSP employee based in Papua New Guinea is expected to serve continuously in Papua New Guinea for a period of at least 91 days. Therefore, these periods of 'foreign service' meet the test that Australian residents working overseas must be engaged *for a continuous period of not less than 91 days*. Should an employee of PNG HSSP depart Papua New Guinea prior to the completion of 91 days of continuous service, that employee will normally be ineligible for the exemption.

30. However, in certain instances, an employee who departs Papua New Guinea 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*).

Derived foreign earnings

31. The definition of 'foreign earnings' is 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.'

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

33. The remuneration of posted PNG HSSP employees takes the form of a continuation of an annual salary entitlement (including leave entitlements) and the payment of various allowances.

34. Salary and allowances are specifically included in the subsection 23AG(7) definition of 'foreign earnings'.

35. Whilst the salary of PNG HSSP employees is paid into Australian financial institutions in Australia, those 'earnings' are still considered 'foreign earnings'. Subsection 23AG(1) provides an implicit connection between 'foreign earnings' and 'foreign service', that is, '*any foreign earnings derived by the person from **that** foreign service is exempt from tax*' (emphasis added). The direct linkage of earnings to service negates the need to consider any potential 'source' issues, even though the source of remuneration under a normal contract of employment is generally regarded as the place where the duties are performed (*FC of T v. French* (1957) 98 CLR 398).

From that foreign service

36. 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.

37. In the case of allowances paid after the 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 paid to the taxpayer prior to the undertaking of foreign service against salary arising from the undertaking of that foreign service would be treated as foreign earnings from foreign service.

Certain foreign earnings not exempt

38. Subsection 23AG(2) provides that no exemption is available under subsection 23AG(1) 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 double tax agreement or a law of a country that gives effect to such an agreement (paragraphs 23AG(2)(a) and (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
- 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)).

39. The foreign earnings derived by PNG HSSP employees in Papua New Guinea would not normally be affected by subsection 23AG(2). Under the treaty, PNG would usually be able to tax the foreign earnings derived from the posting because such employment is exercised in that country (see Article 15). However, that taxing right would not be exercisable where the person is present in PNG for a period of 90 days or less in the PNG year of income (Article 15(2)). In this situation (which would only apply in a limited number of cases), the treaty would grant Australia sole taxing rights over the foreign earnings derived in that year of income. The income would be exempt in PNG solely because of a double tax agreement and would not qualify for exemption under subsection 23AG(1).

40. For example, a PNG HSSP employee is deployed to PNG for the first time on 1 December 2003 and stays there until 30 April 2004. The PNG year of income ends on 31 December. In the PNG 2003 year of income, the employee is present in PNG for less than 90 days. Under Article 15(2) of the treaty, PNG does not have a taxing right over the foreign earnings derived in respect of the period from 1 December 2003 to 31 December 2003. Because those foreign earnings are exempt from tax in PNG solely because of the treaty, the foreign earnings are not exempt in Australia under section 23AG. However, PNG does have a taxing right under the treaty over the foreign earnings derived in respect of the period from 1 January 2004 to 30 April 2004. This means the foreign earnings derived from this period of service will be exempt from tax in Australia under section 23AG.

41. Apart from the situation above, none of the other conditions set out in subsection 23AG(2) are satisfied, i.e. PNG generally taxes employment income and the posting is not diplomatic or consular in nature.

Other relevant information

42. The 'foreign earnings' of PNG HSSP 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.

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

Example

44. In the 2002 - 2003 income year, a PNG HSSP employee derived the following types of income:

- Australian employment income of \$45,000
- Foreign exempt employment income of \$15,000

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

The total amount of Australian tax payable on the employee's income will be calculated with reference to the following formula:

$$\frac{\textit{Notional gross tax}}{\textit{Notional gross taxable income}} \times \textit{Other taxable income}$$

Step 1

The employee's ***notional gross taxable income*** is \$60,000 (\$45,000 + \$15,000)

Step 2

The ***notional gross tax*** is \$16,480 (the normal Australian income tax \$15,580 and Medicare levy \$900 payable on a taxable income of \$60,000)

Step 3

The ***other taxable income*** is \$45,000 (Australian employment income)

Step 4

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

$$\begin{array}{rcl} \frac{\$16,480}{\$60,000} & \times & \$45,000 \\ & & = \\ & & \$12,360.00 \end{array}$$

Detailed contents list

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Commissioner of Taxation1 October 2003

Previous draft:

Not previously issued in draft form

- foreign salary & wages
- foreign source income
- International Tax
- overseas countries
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- residence of individuals
- Papua New Guinea

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20;
TR 96/15; TR 97/16; IT 2650

Subject references:

- foreign income

Legislative references:

- ITAA 1936 23AG

- ITAA 1936 SubdivAA of Div 2
- ITAA 1936 23AG(1)
- ITAA 1936 23AG(2)
- ITAA 1936 23AG(2)(a)
- ITAA 1936 23AG(2)(b)
- ITAA 1936 23AG(2)(c)
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- ITAA 1936 23AG(7)
- ITAA 1936 27A(1)
- ITAA 1936 27A(1)(ja)
- ITAA 1936 27A(1)(k)
- ITAA 1936 27A(1)(ka)
- ITAA 1936 27A(1)(m)
- ITAA 1936 27A(1)(ma)
- ITAA 1936 27A(1)(n)
- ITAA 1936 27A(1)(p)
- Copyright Act 1968
- TAA 1953 PtIVAAA

Case references:

- *FC of T v. French* (1957)
98 CLR 398

ATO References

NO: 2003/12690
ISSN 1445-2014