



***CR 2004/109 - Income tax: exempt foreign
employment income: section 23AG: Australian
Federal Police personnel on long term,
non-diplomatic posting to East Timor (Timor-Leste)
under the auspices of the Timor-Leste Police
Development Program***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *10 June 2004*



Class Ruling

Income tax: exempt foreign employment
income: section 23AG: Australian
Federal Police personnel on long term,
non-diplomatic posting to East Timor
(Timor-Leste) under the auspices of the
Timor-Leste Police Development Program

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

Class of persons

3. Subject to paragraphs 4 and 5 of this Ruling the class of persons to which this Ruling applies are Australian Federal Police (AFP) employees who are residents of Australia for tax purposes and are deployed to the Democratic Republic of Timor-Leste (referred to in this Ruling as East Timor) under the auspices of the Timor-Leste Police Development Program.

4. The class of persons includes AFP employees who while on deployment to East Timor return to Australia for a period during which they utilise leave that has wholly accrued from their service in East Timor.

5. The class of persons does not include AFP employees who while on deployment to East Timor return to Australia for a period during which they utilise leave that has wholly or partly accrued from service in Australia or from a previous period of foreign service.

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 12 to 24.

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 10 June 2004 until it is withdrawn (see paragraph 11). 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 (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.

Withdrawal

11. This Ruling is withdrawn and ceases to have effect after 31 December 2008. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into 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

12. The arrangement 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 Tax 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 arrangement are:

- the application for a class ruling dated 10 June 2004;
- the Timor-Leste Police Development Program – Project Design Framework;
- Australian Federal Police (Overseas Conditions of Service) Determination (No 1) 2001;
- Australian Federal Police – International Deployment Group – AFP Determination No 1 of 2004; and
- further information provided by the applicant.

13. On 25 August 2003, the Australian Government announced a program of capacity building assistance for the law and justice sector of East Timor. This program will be delivered jointly through the Australian Government's aid program (AusAID) and the Australian Federal Police and will be known as 'The Timor-Leste Police Development Program'.

14. Employees selected for deployment under the Timor-Leste Police Development Program will be employees of the AFP.

15. AFP employees posted to East Timor under the Timor-Leste Police Development Program will not be afforded diplomatic status and will not be attached to a diplomatic mission.

16. AFP employees deployed to perform duties under the Timor-Leste Police Development Program will continue to be paid salary and other remuneration by the AFP or their respective State or Territory police force where applicable.

17. AFP employees deployed to East Timor under the Timor-Leste Police Development Program will comprise two categories:

- initial police advisers; and
- additional police advisers.

18. The initial police advisers will be deployed for a two year posting and are sworn officers of the AFP. The conditions of service for these members are contained in AFP (Overseas Conditions of Service) Determination (No. 1) 2001.

19. The initial police advisers deployed to East Timor under the Timor-Leste Police Development Program will be entitled to some or all of the following allowances:

- composite allowance;
- transfer allowances;
- overseas loading;
- location allowance;
- cost of living allowance;
- overseas interim allowance;
- miscellaneous post specific allowance; and
- transfer allowance.

20. The initial police advisers are entitled to the following categories of leave:

- Annual Leave;
- Personal Leave;
- Bereavement Leave;
- Miscellaneous Leave with Pay; and
- Miscellaneous Leave without Pay.

21. The initial police advisers are entitled to two return trips to their home base or an alternative location during the period of their deployment. The initial police advisers must utilise Recreation Leave for a minimum of five working days for these trips and must leave East Timor for the duration of that leave. Where their posting to East Timor exceeds one year, the initial police advisers must undertake one further trip, utilising Recreation Leave for five working days, which must be taken in Australia. In addition, the initial police advisers may be entitled to further travel to reunite with dependants.

22. The additional police advisers will be drawn from the International Deployment Group (IDG) and will be deployed for a rotation of 16 weeks. Members of the IDG are sworn officers of the AFP or employees of an Australian state or territory police force who have been sworn in as a special member serving as a sworn AFP

employee. The conditions of service for the additional police advisers are contained in AFP – IDG – AFP Determination No 1 of 2004.

23. The additional police advisers deployed to East Timor under the Timor-Leste Police Development Program will be entitled to some or all of the following allowances:

- pre-deployment composite allowance;
- post-deployment composite allowance;
- extended unaccompanied overseas service allowance;
- mission allowance;
- transfer allowance;
- telephone/communications allowance; and
- meals and accommodation allowance.

24. The additional police advisers are not permitted to take leave during their 16 week posting. However, they are required to take a minimum of four weeks leave after the end of their deployment. The leave taken may or may not be accrued from their posting to East Timor under the Timor-Leste Police Development Program.

Ruling

25. Subject to paragraph 26, the salary and allowances referred to in paragraphs 16, 19, and 23 of this ruling, derived by an AFP employee described in paragraph 3 of this ruling deployed to East Timor, are exempt from tax under subsection 23AG(1) where:

- the employee has been engaged, or is taken to have been engaged, in service in East Timor 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 East Timor.

26. The pre-deployment allowance referred to in paragraph 23 is not exempt from tax under subsection 23AG(1).

Explanation

27. Subsection 6-5(2) of the *Income Tax Assessment Act* (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.

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

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

30. 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.

31. 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.

32. 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.

33. 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'.

34. However, certain foreign earnings that meet these tests may not be exempt from tax (see paragraphs 58 to 65).

Resident of Australia

35. 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 of this ruling who remain Australian residents for tax purposes during their deployment to East Timor.

36. However, it is expected that AFP employees who are deployed to East Timor under the Timor-Leste Police Development Program will remain residents of Australia throughout the period of their deployment.

Engaged in foreign service

37. '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)).

38. 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'.

39. AFP employees referred to in paragraph 3 meet the above definition of an 'employee'.

40. Deployment of an AFP employee to East Timor 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

41. Each AFP employee based in East Timor is expected to serve continuously in East Timor for a period of not less than 91 days. The initial police advisers are expected to serve two year term posting and the additional police advisers are expected to serve a 16 week rotation. These periods of 'foreign service', if met, meet the test that Australian residents working overseas must be engaged 'for a continuous period of not less than 91 days'.

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

43. However, in certain instances, an AFP employee who departs East Timor 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 to paragraphs 9 to 16 of Taxation Ruling TR 96/15).

44. Subsection 23AG(6) and paragraph 11 of TR 96/15 treat certain temporary absences from foreign service as forming part of the period of foreign service.

45. 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.

46. Where an AFP employee is temporarily absent from foreign service due to any of the absences listed in subsection 23AG(6) or paragraph 11 of TR 96/15, these absences will be taken to form part of the period of foreign service.

47. For example, where an initial police adviser deployed to East Timor takes recreation leave to return to Australia or another country on a mandatory break or for the purposes of a reunion visit, and the leave taken is wholly attributable to the deployment under the Timor-Leste Police Development Program, the leave period forms part of the foreign service period.

48. Leave taken that is wholly or partly attributable to a period of service other than the period of foreign service performed under the Timor-Leste Police Development Program will not be taken to form part of the period of foreign service.

Foreign earnings

49. 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.

50. 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.

51. The remuneration of the AFP employee takes the form of an annual salary entitlement and the payment of various allowances (see paragraphs 16 to 24).

52. These salaries, bonuses and allowances are specifically included in the subsection 23AG(7) definition of 'foreign earnings'.

53. Whilst the salary of an AFP employee may be paid into financial institutions in Australia, those 'earnings' are still considered to be 'foreign earnings'.

From that foreign service

54. 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.

55. In the case of allowances or performance bonuses paid after the person returns to Australia that relate to the period of foreign service, such allowances or bonuses 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.

56. The salary that is paid when taking recreation leave that wholly 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.

57. An AFP employee is entitled to a composite allowance while undertaking pre-deployment training prior to engaging in foreign service. The composite allowance payable during the pre-deployment period is not derived from foreign service. It is derived as a result of the training undertaken prior to leaving Australia and does not therefore, qualify for exemption under section 23AG.

Certain foreign earnings are not exempt

58. 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)).

59. However, if the foreign earnings are exempt from tax in the foreign country because of another reason (for example a Memorandum of Understanding [MOU] or some similar agreement), subsection 23AG(2) will not apply to deny the exemption under subsection 23AG(1). This is because the foreign earnings are not exempt in the foreign country solely because of events listed in that subsection – the foreign earnings are also exempt because of the MOU or similar agreement which is not a reason listed in subsection 23AG(2).

60. There is currently no double tax agreement between Australia and East Timor.

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

62. The foreign earnings derived by AFP employees in East Timor are not currently exempt from income tax in East Timor.

63. The Governments of Australia and East Timor have concluded a MOU covering Technical Cooperation for Development. Paragraph XI of the MOU exempts Australian Project Personnel (including AFP employees deployed under the Timor-Leste Police Development Program) from taxation in East Timor. However the MOU will take effect only upon passage of implementing statutory legislation in East Timor. No such legislation has been implemented at the time of making this ruling.

64. As the foreign earnings of the AFP employees are not exempt from tax in East Timor for any of the reasons listed in subsection 23AG(2), that subsection will not apply to deny the exemption under subsection 23AG(1).

65. When the MOU referred to in paragraph 63 comes into effect, the foreign earnings of the AFP employees will be exempt from income tax in East Timor. However, as the foreign earnings are exempt for a reason other than those listed in subsection 23AG(2), the foreign earnings will continue to be exempt under subsection 23AG(1).

Exemption with progression

66. 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)).

67. 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.

68. 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 East Timor are deductible from exempt income.

Example

69. In the 2004-2005 income year, an AFP employee derives 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 AFP 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:

(Notional gross tax/Notional gross taxable income) × 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

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

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Commissioner of Taxation

6 October 2004

<i>Previous draft:</i>	- ITAA 1936 23AG(2)(b)
Not previously issued as a draft	- ITAA 1936 23AG(2)(c)
	- ITAA 1936 23AG(2)(d)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 23AG(2)(e)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 23AG(2)(f)
TR 96/15; TR 97/16; IT 2650	- ITAA 1936 23AG(2)(g)
	- ITAA 1936 23AG(3)
<i>Subject references:</i>	- ITAA 1936 23AG(6)
- East Timor	- ITAA 1936 23AG(7)
- foreign exempt employment	- ITAA 1936 Pt III Div 2 Subdiv AA
income	- ITAA 1936 27A(1)(ja)
- foreign income	- ITAA 1936 27A(1)(k)
- foreign salary & wages	- ITAA 1936 27A(1)(ka)
- foreign source income	- ITAA 1936 27A(1)(m)
- international tax	- ITAA 1936 27A(1)(ma)
- overseas countries	- ITAA 1936 27A(1)(n)
- overseas tax laws	- ITAA 1936 27A(1)(p)
- residence of individuals	- ITAA 1997 6-5(2)
	- ITAA 1997 6-15(2)
	- ITAA 1997 11-15
<i>Legislative references:</i>	- Copyright Act 1968
- ITAA 1936 23AG	- TAA 1953 Pt IVAAA
- ITAA 1936 23AG(1)	
- ITAA 1936 23AG(2)	
- ITAA 1936 23AG(2)(a)	

ATO references

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