

***CR 2005/53 - Income tax: assessable income:
Department of Finance and Administration and
Department of the Treasury employees deployed to
Nauru***

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Class Ruling

Income tax: assessable income:
Department of Finance and Administration
and Department of the Treasury
employees deployed to Nauru

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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 IVA 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. Subject to paragraphs 4 and 5 of this Ruling, the class of persons to which this Ruling applies is employees of the Department of Finance and Administration (Finance) and the Department of the Treasury (Treasury) who are deployed to Nauru under the Memorandum of Understanding (MOU) between the Government of Australia and the Government of Nauru for Cooperation in the Management of Asylum Seekers and Related Issues and the Agreement between Australia and Nauru Concerning Additional Police and Other Assistance to Nauru (the Agreement) and who remain Australian residents throughout the period of deployment.

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

5. The class of person does not include Finance and Treasury employees who while on deployment to Nauru return to Australia for a period during which they utilise leave that has wholly or partly accrued from service in Australia.

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 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 1 July 2004. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 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 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:

- Application for Class Ruling (dated 12 November 2004) received 25 November 2004;
- Guide to Conditions of Employment – Nauru Finance Team; and
- Copy of the Agreement between Australia and Nauru Concerning Additional Police and Other Assistance to Nauru provided in a facsimile sent by the applicant (dated 10 December 2004) received 10 December 2004.

12. Finance and Treasury officers who are ongoing employees under the *Public Service Act 1999* will be deployed to Nauru under the MOU signed on 25 February 2004 and the Agreement between Australia and Nauru which was signed on 10 May 2004.

13. Under the Agreement and the MOU, the Australian government is providing officers to the Nauru Department of Finance.

14. The initial deployed employees comprise officers from Finance and from Treasury, who took up their positions in Nauru in July 2004.

15. The period of deployment of officials will be at least 91 days and usually from six to 12 months.

16. Deployments could also be extended for the period of the current Agreement until at least June 2007.

17. Additional Finance and Treasury officials may replace current deployed employees under rotational arrangements.

18. Salary and other allowances will continue to be paid into the employee's nominated bank account on a fortnightly basis.

19. Employees will be covered by normal Commonwealth Superannuation Scheme (CSS) and Public Sector Superannuation Scheme (PSS) superannuation.

20. Finance and Treasury employees will be entitled to the following allowances:

- Cost of Posting Allowance;
- Hardship Allowance;
- Child Allowances;
- Additional Household Allowance; and

- Transfer Allowance

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

22. 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.

23. An employee may return to Australia in exceptional circumstances for example major illness of the employee or in their family.

24. Article 11.4 of the Agreement provides that Designated Persons such as Finance and Treasury employees deployed to Nauru shall be exempt from taxation by the Government of Nauru on their pay and other emoluments.

Ruling

25. Subject to paragraph 26, the salary and allowances referred to in paragraphs 18 and 20 of this Ruling, derived by a Finance or Treasury employee described in paragraphs 3 to 5 of this Ruling deployed to Nauru, 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 Nauru 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 Nauru.

26. The Transfer Allowance referred to in paragraph 20 is not exempt from tax under subsection 23AG(1) of the ITAA 1936.

Explanation

27. 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.

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) 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.

33. 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 60 to 65).

Resident of Australia

34. 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 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 Nauru.

35. This Ruling is based on the assumption that Finance and Treasury employees deployed to Nauru will remain Australian residents for tax purposes throughout the period of their deployment.

Engaged in foreign service

36. '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).

37. 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'.

38. Finance and Treasury employees referred to in paragraph 3 of this Ruling are considered to meet the above definition of an 'employee'.

39. Deployment of a Finance or Treasury employee to Nauru 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

40. Each Finance or Treasury employee based in Nauru is expected to serve continuously in Nauru 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'.

41. Should an employee of Finance or Treasury depart Nauru prior to the completion of 91 days of continuous service, that employee will normally be ineligible for the exemption.

42. However, in certain instances, an employee who departs Nauru 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).

Temporary absences

43. Subsection 23AG(6) of the ITAA 1936 and paragraph 11 of TR 96/15 treat certain temporary absences from foreign service as forming part of the period of foreign service.

44. 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.

45. Where a Finance or Treasury 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.

46. In respect of periods spent by Finance and Treasury employees on visits to Australia as described in paragraph 22 of this Ruling, 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.

47. If a Finance or Treasury employee who is in Australia as described in paragraph 22 of this Ruling, extends their stay to take recreational leave that accrued wholly from foreign service in Nauru, that period of leave is taken to form part of the employee's foreign service.

Temporary absences utilising leave entitlements from employment in Australia

48. As advised in paragraph 5 of this Ruling, Finance and Treasury 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.

49. In certain limited circumstances, an employee who is temporarily absent from Nauru 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 of the ITAA 1936. Finance and Treasury 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) of the ITAA 1936 to their circumstances.

Foreign earnings

50. 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 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.

51. The exclusions to the definition of 'foreign earnings' in paragraph 50 are not, however, relevant to this arrangement as they relate to pensions, annuities, eligible termination payments and other similar amounts.

52. The remuneration of posted Finance and Treasury employees takes the form of an annual salary entitlement and the payment of various allowances (see paragraphs 18 and 20).

53. These salary and allowances described in paragraphs 18 and 20 come within the definition of 'foreign earnings' in subsection 23AG(7) of the ITAA 1936.

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

From that foreign service

55. 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.

56. 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.

57. 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 service, even though the recreation leave may be taken after the completion of the foreign service.

58. The receipt of the following allowances:

- Cost of Posting Allowance;
- Hardship Allowance;
- Child Allowances; and
- Additional Household Allowance,

are considered to be exempt as the allowances are related to engaging in foreign service in Nauru.

59. Finance and Treasury 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 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 of the ITAA 1936.

Certain foreign earnings not exempt

60. 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 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)).

61. There is currently no double tax agreement between Australia and Nauru.

62. The privileges and immunities of persons connected with an international organisation do not apply to Finance and Treasury employees working in Nauru.

63. The foreign earnings derived by Finance and Treasury employees in Nauru are not subject to income tax as the law of Nauru does not provide for the imposition of income tax on any of the categories of income listed at paragraphs 18 and 20. Therefore, the income will not be exempt from income tax under subsection 23AG(1) of the ITAA 1936 because paragraph 23AG(2)(d) of the ITAA 1936 applies.

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

65. The Agreement addresses taxation matters at Article 11.4. The Agreement includes a specific clause exempting income from taxation in Nauru and the exemption contained in 23AG(1) of the ITAA 1936 would thus still apply.

Exemption with progression

66. The 'foreign earnings' of Finance and Treasury 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)).

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.

Example

68. In the 2004-2005 income year, Daniel, a Finance 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.

The foreign exempt income was earned from a deployment in Nauru

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:

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

Step 1

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

Step 2

The **notional gross tax** is \$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 Daniel's Australian income is:

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

Detailed contents list

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

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Commissioner of Taxation

29 June 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; 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
- Nauru
- overseas countries
- overseas tax laws
- residence of individuals

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(6D)
- ITAA 1936 23AG(7)

- ITAA 1936 Subdiv AA Div 2
- ITAA 1936 27A(1)
- ITAA 1997 6-5
- ITAA 1997 6-5(2)
- ITAA 1997 6-15(2)
- ITAA 1997 11-15
- TAA 1953 Pt IVA
- Copyright Act 1968

Other references:

- The Agreement between Australia and Nauru Concerning Additional Police and Other Assistance to Nauru

ATO references

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