



CR 2006/119 - Income tax: assessable income: employees of the Australian Public Service and the Australian Federal Police working in Papua New Guinea as part of the Enhanced Cooperation program

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 This document has changed over time. This is a consolidated version of the ruling which was published on 6 December 2006



Class Ruling

Income tax: assessable income:
employees of the Australian Public
Service and the Australian Federal Police
working in Papua New Guinea as part of
the Enhanced Cooperation program

Contents Para

LEGALLY BINDING SECTION:

What this Ruling is about 1

Date of effect 11

Previous Ruling 15

Scheme 16

Ruling 57

NOT LEGALLY BINDING SECTION

Appendix 1:

Explanation 61

Appendix 2:

Detailed contents list 117

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This publication (excluding appendices) 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 (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided 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:

- employees of the Australian Public Service (APS employees); and
- Australian Federal Police employees (AFP employees), being:
 - (i) employees of the AFP;
 - (ii) persons seconded to the AFP under section 69D of the *Australian Federal Police Act 1979* (AFP Act 1979) for the purposes of deployment as part of the International Deployment Group (IDG), for the period of their deployment; or
 - (iii) persons appointed to the AFP as special members of the AFP under section 40E of the AFP Act 1979 for the purposes of deployment as part of the IDG, for the period of their deployment,

who are deployed to Papua New Guinea (PNG) as part of the Enhanced Cooperation program (the ECP) under the Joint Agreement of Enhanced Co-operation (JAEC) or the Development Cooperation Treaty (DCT).

4. AFP and APS employees remain Australian residents throughout the period of deployment. This Ruling is based on the assumption that AFP and APS employees deployed to PNG are Australian residents for tax purposes throughout the period of their deployment.

5. APS and AFP employees include employees who, whilst on deployment to PNG, return to Australia for a period during which they utilise leave that has wholly accrued from their service in PNG.

6. The class of entities does not include APS and AFP employees:

- who while on deployment to PNG return to Australia for a period during which they utilise leave that has wholly or partly accrued from service in Australia;
- whose term of deployment to PNG is suspended or terminated before completing a continuous period of foreign service of not less than 91 days; or
- whose term of deployment is less than 91 days.

Qualifications

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

8. 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 56 of this Ruling.

9. 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.

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Date of effect

11. This Ruling applies from 6 December 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:

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

12. 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)).

13. 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.

14. 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).

Previous Rulings

15. This Ruling was previously issued as Class Ruling CR 2004/73.

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 1 April 2005);
- APS Terms and Conditions of Employment for deployment to PNG;
- AFP Certified Agreement 2003-2006 (AFP Certified Agreement);
- AFP – International Deployment Group – Determination No. 19 of 2005;
- the AFP – International Deployment Group – Determination No. 20 of 2005;
- Commonwealth of Australia – AFP Act 1979 – Determination No. 2 of 2006;
- Joint Agreement on Enhanced Co-operation between Australia and Papua New Guinea 13 August 2004 (the JAEC Treaty);
- Treaty on Development Co-operation between the Government of Australia and the Government of PNG 31 July 2000 (the DCT Treaty); and
- further information supplied by the applicant.

17. Under the ECP, the Australian Government has agreed to send APS and AFP employees to provide assistance to PNG in order to facilitate growth and stability by addressing core issues in PNG in the areas of governance, law and order and justice, transport and border security, financial management, economic and social progress as well as capacity in public administration. The ECP is administered by the Australian Agency for International Development (AusAID) with additional support provided by the employees' home agencies for deployment of APS officials and by AFP for police personnel.

18. It is expected that APS and AFP employees will be deployed to PNG for a minimum period of 91 days.

19. APS and AFP employees will not be afforded diplomatic status and will not be attached to a diplomatic mission.

20. Clause 12 of the Annex to the DCT Treaty grants Australian personnel, including APS and AFP employees deployed to PNG an exemption from PNG income tax or other taxes on their salaries and allowances.

21. Clause 14 of the JAEC Treaty grants Designated Persons, including APS and AFP employees deployed to PNG an exemption from taxation by the PNG government on their pay and other emoluments.

APS employees

22. The Secretary of an APS employee's home agency may at any time direct the APS employee to return to Australia. If such a direction is given, the employee must comply with it immediately. An APS employee returning to Australia on compassionate grounds may be redeployed at a later date, after the reason for the employee's return no longer exists. An APS employee may elect to return from the posting prior to the agreed date following an application to that effect from the employee being considered by the relevant Secretary.

23. APS employees will be deployed for a period specified by the Secretary, but is expected to be a minimum of 12 months.

24. Salary and other remuneration entitlements will continue to be paid to APS employees on a fortnightly basis by their home agency during deployment and they will remain eligible for performance bonuses, if applicable.

25. APS employees deployed to PNG will also be entitled to some or all of the following allowances:

- cost of posting allowance;
- hardship allowances;
- child allowance;
- additional household allowance;
- reunion/disturbance allowance; and
- transfer allowance.

26. APS employees will accrue recreation, sick (personal) and long service leave entitlements as per the Certified Agreements for the employee's home Agency while deployed to PNG. APS employees deployed to PNG will also be entitled to an additional ten days recreation leave per annum.

27. APS employees deployed to PNG may take recreation leave in accordance with their home agency's policy and with the agreement of their manager in PNG. APS employees may utilise recreation leave to return to Australia (for example, for reunion visits).

AFP employees

28. 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.

29. AFP employees may be deployed to PNG under AFP – IDG – Determination No. 19 of 2005, AFP – IDG – Determination No. 20 of 2005 or Commonwealth of Australia – AFP Act 1979 – Determination No. 2 of 2006.

Determination No. 19 of 2005

30. For these AFP employees deployed under AFP – IDG – Determination No. 19 of 2005, the period of deployment will be 40, 60, 80 or 100 weeks.

31. For terms of deployment of 40 weeks the period of overseas duty will be two × 16 weeks of overseas service. For terms of deployment of 60 weeks the period of overseas duty will be three × 16 weeks of overseas service. For terms of deployment of 80 weeks the period of overseas duty will be four × 16 weeks of overseas service. For terms of deployment of 100 weeks the period of overseas duty will be five × 16 weeks of overseas service.

32. AFP employees deployed to PNG will be entitled to some or all of the following allowances:

- composite allowance (paid during pre-deployment training);
- composite allowance (paid during posting and deployment accrued recreation leave);
- transfer allowance (to and from deployment);
- extended unaccompanied overseas service allowance;
- mission allowance;
- telephone/communications allowance;
- field accommodation allowance; and
- meals and accommodation allowances (if applicable) and incidental allowance.

33. Only the composite allowance will be paid while an AFP employee is on leave accrued during the deployment period.

34. During the period of deployment, AFP employees will accrue recreation leave as outlined in paragraphs 35 to 38 of this Ruling. Miscellaneous leave may also be granted for special circumstances (for example, death of a close family member).

35. For terms of deployment of 40 weeks, eight weeks recreation leave will be accrued less six days for additional training, briefing, debriefing and travel.

36. For terms of deployment of 60 weeks, 12 weeks recreation leave will be accrued less nine days for additional training, briefing, debriefing and travel.

37. For terms of deployment of 80 weeks, 16 weeks recreation leave will be accrued less 12 days for additional training, briefing, debriefing and travel.

38. For terms of deployment of 100 weeks, 20 weeks recreation leave will be accrued less 15 days for additional training, briefing, debriefing and travel.

39. The general expectation is that AFP employees will be required to take recreation leave in blocks of four weeks, each block following a 16 week deployment. This may vary due to mission-specific requirements, however, employees will be provided with leave as outlined in paragraphs 35 to 38 of this Ruling.

40. Recreation leave and mandatory recreation leave already accrued by the AFP employees prior to their deployment will be held over until their term of deployment ceases.

41. During the periods of leave following each posting, the AFP employees will make themselves available for additional training, briefing and debriefing at the discretion of the National Manager of the IDG.

42. During the term of deployment, the leave entitlements referred to in paragraphs 35 to 38 of this Ruling replace the AFP employees entitlement to recreation leave and mandatory recreation leave prescribed under the AFP Certified Agreement.

43. However, where the AFP employee voluntarily terminates their term of deployment prior to the completion of six months, the employee is not entitled to the recreation leave referred to in paragraphs 35 to 38 of this Ruling. The employee will then be entitled to recreation leave under the AFP Certified Agreement.

44. Training, briefing and debriefing may be conducted in person, by telephone or any other communication method determined by the National Manager of the IDG.

45. The AFP employee is entitled to no other leave whilst deployed. The National Manager of the IDG may, upon request from an AFP employee, consider any special circumstances in respect of the employee (for example the death of a close family member) to determine whether to return the employee to their home base on miscellaneous leave. In so doing, the deployment is suspended.

Determination No. 20 of 2005

46. For those AFP employees deployed under AFP – IDG – Determination No. 20 of 2005, the period of deployment will be 12 months or more.

47. AFP employees posted to PNG will be entitled to some or all of the following allowances:

- composite overseas loading (paid during posting);
- transfer allowances (pre-departure);
- location allowance;
- extended overseas unaccompanied allowance;
- communication allowance;
- boarding allowance (if applicable); and
- transfer allowance (repatriation).

48. Allowances will be paid while the AFP employee is on leave accrued during the deployment period.

49. The AFP employees posted in PNG are entitled to AFP Certified Agreement leave as follows:

- standard recreation leave;
- mandatory recreation leave;
- personal leave;
- miscellaneous leave with/without pay;
- purchased recreation leave;
- maternity leave; and
- adoption leave.

50. 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.

51. The employee's team leader may approve recreation leave subject to operational requirements and the employee's leave balance. However, this would generally be restricted to leave accrued during deployment.

52. In addition to standard recreation leave AFP employees will accrue a further five 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.

Determination No. 2 of 2006

53. For those AFP employees deployed under the Commonwealth of Australia – AFP Act 1979 – Determination No. 2 of 2006, the period of deployment will be short term between one day and six months.

54. AFP employees may receive some or all of the following allowances:

- composite allowance (paid during deployment);
- transfer allowance (to and from deployments of more than one month);
- mission allowance;
- meals and accommodation allowances (if applicable) and incidental allowance;
- communication allowance; and
- field accommodation allowance.

55. Leave entitlements are in accordance with the AFP Certified Agreement described in paragraph 49 to 52 of this Ruling, excluding purchased recreation leave, maternity leave and adoption leave.

56. Leave would generally not be approved during the PNG posting and additional rest periods may be granted to compensate for additional time worked.

Ruling

57. Subject to paragraph 58, the salary, bonuses and allowances referred to in paragraphs 24, 25, 28, 32, 47 and 54 of this Ruling, derived by APS and AFP employees described in paragraphs 3 to 5 of this Ruling deployed to PNG 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 PNG for a continuous period of not less than 91 days; and
- the salary, bonuses and allowances are derived from that foreign service, including payments for recreation leave that has wholly accrued from the period of service in PNG.

58. The composite allowance paid whilst undertaking pre-deployment training and transfer allowances referred to in paragraphs 25, 32, 47 and 54 of this Ruling are not exempt from tax under subsection 23AG(1) of the ITAA 1936.

59. Where the salary, bonuses and allowances are exempt from tax under paragraph 57 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

60. In the 2006-2007 income year, Daniel, an 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:

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

Step 1

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

Step 2

The **notional gross tax** is \$25,200 (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:

$$(\$25,200/\$90,000) \times \$60,000 = \$16,800$$

Note: this calculation is based on the 2006-2007 income tax rates. If the income tax rates for future years change, you should refer to the tax rates for that current income year.

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.*

61. 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.

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

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

64. 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.

65. 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.

66. 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.

67. 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 105 to 113 of this Ruling).

Resident of Australia

68. 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 5 of this Ruling who remain Australian residents for tax purposes for the purposes during their deployment to PNG.

69. APS and AFP employees deployed to PNG under the ECP are Australian residents for tax purposes throughout the period of their deployment.

Engaged in foreign service

70. '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).

71. 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'.

72. APS and AFP employees referred to in paragraphs 3 to 5 of this Ruling are considered to meet the above definition of an 'employee'.

73. Deployment of APS and AFP employees to PNG 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

74. Each APS and AFP employee based in PNG is expected to serve continuously in PNG 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'.

75. Should an APS and AFP employee depart PNG prior to the completion of 91 days of continuous service, that employee will normally be ineligible for the exemption.

76. However, in certain instances, an APS and AFP employee who departs PNG 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 12 of Taxation Ruling TR 96/15 and paragraphs 91 to 93 of this Ruling).

Temporary absences forming part of a period of foreign service

77. 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.

78. 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.

79. 'Recreation leave' is leave in the nature of paid holidays to which an employee has accrued an entitlement. Most usually it is the employee's accrued annual leave. Leave which fits this description is 'recreation leave', even if it is not called this.

80. However, 'recreation leave' does not include:

- leave that is not in the nature of paid holidays, such as weekends, rostered days off, flexidays, and days off in lieu;
- public holidays;
- leave wholly or partly attributable to a period of employment other than foreign service;
- long service leave, furlough, extended leave or similar leave; and
- leave without pay or on reduced pay.

81. During the period of deployment, APS employees will accrue entitlements to recreation leave in accordance with the APS Certified Agreement plus an additional 10 days per annum.

82. During the period of deployment, AFP employees deployed under Determination No. 19 of 2005 will accrue four weeks recreation leave (less days for additional training, briefing, debriefing and travel) after each 16 week deployment block.

83. During the period of deployment, AFP employees deployed under Determination 20 of 2005 or Determination No. 2 of 2006 will accrue:

- 240 hours standard recreation leave per annum on a monthly pro-rata basis. Recreation leave is credited to the employee on the first day of each month; and
- mandatory recreation leave of a further five days per annum on the basis of one day for two months worked.

84. Given the nature of the overseas deployment, it is considered that the recreation leave in paragraphs 81 to 83 of this Ruling granted to APS and AFP employees deployed to PNG is reasonable. This recreation leave is wholly attributable to the period of foreign service and forms part of a continuous period of foreign service for the purposes of subsection 23AG(1) of the ITAA 1936.

85. Where an AFP employee purchases recreation leave, the employee's base salary is adjusted by the amount of the leave purchased and they will receive a reduced fortnightly salary. This leave is not recreation leave as it is not in the nature of paid holidays to which an employee has accrued an entitlement, but rather is leave on reduced pay (see paragraphs 79 and 80 of this Ruling). The AFP employee needs to consider the discussion at paragraphs 89 and 90 of this Ruling to determine whether the continuity of foreign service can be maintained.

86. An employee's period of continuous foreign service will be maintained where the employee is granted:

- personal leave relating to their sickness or accident; or
- miscellaneous leave with pay or personal leave because of the accident, illness or death of another person where the leave is for a short period.

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

87. In certain limited circumstances, breaks other than those specified in paragraph 78 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 paragraphs 89 and 90 of this Ruling.

88. 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 91 to 93 of this Ruling.

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

89. Where an employee takes leave other than the leave outlined at:

- paragraphs 81 to 83 and 86 of this Ruling; or
- paragraph 87 of this Ruling that is not excessive,

they need to determine whether the continuity of service can be maintained (subsection 23AG(6A) of the ITAA 1936).

90. Paragraphs 91 to 93 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

91. 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.

92. 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 (subsection 23AG(6A) of the ITAA 1936).

93. The 1/6 legislative rule should not be confused with the one-sixth administrative test outlined at paragraphs 87 and 88 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

94. 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 Subdivision 13A, but does not include any payment, consideration or amount that:

- (i) is included in assessable income under Subdivision AA of Division 2; or
- (ii) 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.

95. The exclusions to the definition of 'foreign earnings' in paragraph 94 of this Ruling are not, however, relevant to this arrangement as they relate to pensions, annuities, eligible termination payments and other similar amounts.

96. The remuneration of deployed APS and AFP employees takes the form of an annual salary entitlement (with performance bonuses, where applicable) and the payment of various allowances.

97. These salary, bonuses and allowances which are described in paragraphs 24, 25, 28, 32, 47 and 54 of this Ruling, with the exception of the composite allowance (paid during pre-deployment training) and transfer allowances come within the definition of 'foreign earnings' in subsection 23AG(7) of the ITAA 1936.

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

From that foreign service

99. 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.

100. In the case of allowances or performance bonuses paid after the taxpayer 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.

101. The receipt of the following allowances by APS or AFP employees:

- a. cost of posting allowance;
- b. hardship allowance;
- c. child allowance;
- d. additional household allowance;
- e. reunion/disturbance allowance;
- f. composite allowance/composite overseas loading paid during posting and deployment accrued recreation leave;
- g. extended unaccompanied overseas service allowance/extended overseas unaccompanied allowance;
- h. mission allowance;
- i. telephone/communication allowance;
- j. field accommodation allowance;

- k. meals and accommodation allowances (if applicable) and incidental allowance;
- l. location allowance; and
- m. boarding allowance (if applicable),

is considered to be foreign earnings from the foreign service as they relate to engaging in foreign service in PNG.

102. 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 recreation leave may be taken after the completion of the foreign service.

103. An APS and AFP employee is also entitled to a transfer allowance prior to engaging in foreign service and 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 APS and 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.

104. 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 not exempt

105. 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 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)).

106. Australia has entered into a tax treaty with PNG (the PNG agreement) which is contained in Schedule 29 of the *International Agreements Act 1953* (the Agreements Act).

107. Article 19(1) of the PNG agreement provides that remuneration paid by Australia to any individual in respect of services rendered in the discharge of governmental functions shall be taxable only in Australia. However, such remuneration will be taxable only in PNG if the services are rendered in PNG and the individual is a resident and citizen of PNG, or did not become a resident of PNG solely for the purpose of performing the services.

108. Paragraph 69 of Taxation Ruling TR 2005/8 provides that the term 'services rendered in the discharge of governmental functions' means those services rendered by an employee or office holder in the completion of *any* functions undertaken by government.

109. For the period of deployment, the APS and AFP employees are Australian residents and receive remuneration, in the form of salary, bonuses and allowances, from the Australian government. This remuneration will be received in respect of services rendered as under the ECP in the discharge of governmental functions.

110. Therefore, under article 19(1) of the PNG agreement the income received by the APS and AFP employees while deployed in PNG is taxable only in Australia and, as such, will not be subject to taxation in PNG.

111. Clause 12 of the Annex to the DCT Treaty grants APS and AFP employees deployed to PNG as part of the ECP an exemption from PNG income taxes on their pay and other emoluments. The DCT Treaty is an international agreement, but it does not deal with diplomatic or consular privileges and immunities. Whilst the APS and AFP employees receive privileges and immunities, they do not receive diplomatic or consular immunities.

112. Article 14 of the JAEC Treaty grants APS and AFP employees deployed to PNG as part of the ECP, an exemption from PNG income tax or other taxes on their pay and other emoluments. The JAEC Treaty is an international agreement, but it does not deal with diplomatic or consular privileges and immunities. Whilst the APS and AFP employees receive privileges and immunities, they do not receive diplomatic or consular immunities.

113. As a result, the foreign earnings of the deployed APS and AFP employees are not exempt from tax in PNG 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 'foreign earnings' exemption under subsection 23AG(1) of the ITAA 1936.

Exemption with progression

114. The 'foreign earnings' of APS and 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).

115. 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.

116. 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 PNG are deductible from exempt income.

Appendix 2 – Detailed contents list

117. 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 | 7 |
| Date of effect | 11 |
| Previous Rulings | 15 |
| Scheme | 16 |
| APS employees | 22 |
| AFP employees | 28 |
| Determination No. 19 of 2005 | 30 |
| Determination No. 20 of 2005 | 46 |
| Determination No. 2 of 2006 | 53 |
| Ruling | 57 |
| Example | 60 |
| Appendix 1 – Explanation | 61 |
| Resident of Australia | 68 |
| Engaged in foreign service | 70 |
| For a continuous period of not less than 91 days | 74 |
| Temporary absences forming part of a period of foreign service | 77 |
| Temporary absences not breaking the period of foreign service: the one-sixth administrative test | 87 |
| Temporary absences not breaking the period of foreign service: the legislative rule | 89 |
| Continuity of the period of foreign service: 1/6 legislative rule | 91 |
| Foreign earnings | 94 |
| From that foreign service | 99 |
| Certain foreign earnings not exempt | 105 |
| Exemption with progression | 114 |
| Appendix 2 – Detailed contents list | 117 |

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 96/15; TR 2005/8; 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
- PNG
- overseas countries
- overseas employees
- 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)
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- ITAA 1936 Pt III Div 2 Subdiv AA
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- Treaty on Development Co-operation between the Government of Australia and the Government of PNG 31 July 2000

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NO: 2006/20990
 ISSN: 1445-2014
 ATOLaw topic: Income Tax ~~ Exempt income ~~ allowances and benefits
 Income Tax ~~ Exempt income ~~ employment income - foreign sourced