




CR 2006/82 - Income tax: assessable income: employees deployed under the Capacity Building Service Centre (CBSC) program in Papua New Guinea which is administered by the Australian Agency for International Development

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 This ruling contains references to repealed provisions, some of which may have been re-enacted or remade. The ruling has effect in relation to the re-enacted or remade provisions. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. Australia's tax treaties and other agreements except for the Taipei Agreement are set out in the Australian Treaty Series. The citation for each is in a note to the applicable defined term in sections 3AAA or 3AAB of the International Tax Agreements Act 1953.

 This document has changed over time. This is a consolidated version of the ruling which was published on *1 August 2005*



Class Ruling

Income tax: assessable income:
employees deployed under the Capacity
Building Service Centre (CBSC) program
in Papua New Guinea which is
administered by the Australian Agency for
International Development

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

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

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

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

What this Ruling is about

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

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are section 23AG of the *Income Tax Assessment Act 1936* (ITAA 1936) and section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997). Changes to section 23AG of the ITAA 1936 came into effect on 19 December 2005. The Commissioner's interpretation on the treatment of absences in respect of section 23AG of the ITAA 1936 prior to the latest amendments is contained in Taxation Ruling TR 96/15.

Class of entities

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

- JTA International Pty Ltd (JTAI); and
- Pacific Health Group Pty Ltd (PHG),

deployed under the Capacity Building Service Centre (CBSC) program in Papua New Guinea as long term international advisers. The deployment is under the Treaty on Development Co-operation between the Government of Australia and the Government of Papua New Guinea.

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

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

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

7. The class of entities does not include CBSC 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; or
- whose term of deployment to PNG is terminated before completing a continuous period of foreign service of not less than 91 days.

Qualifications

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

9. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 30 of this Ruling.

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

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

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Barton ACT 2600

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Date of effect

12. This Ruling applies from 1 August 2005. 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. Furthermore, the Ruling only applies to the extent that:

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

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

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

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

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

Scheme

16. The scheme that is the subject of the Ruling is described below. This description is based on the following documents which are attached to the file record maintained by the Australian Taxation Office for this Ruling. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the scheme are:

- Application for Class Ruling (dated 5 December 2005) received 7 December 2005;
- JTAI and PHG employee agreements;
- AusAID Code of Conduct for Overseas Service; and
- Treaty on Development Co-operation between the Government of Australia and the Government of PNG 31 July 2000 (the Government Treaty).

17. The CBSC is an AusAID funded program for which the management and implementation is currently contracted to JTAI. JTAI is an Australian resident and is not a PNG resident. JTAI does not maintain a permanent establishment or a fixed base in PNG. JTAI sub-contracts some elements of the contract to PHG including employee payroll and financing.

18. The contract with AusAID for the implementation of the CBSC is for a five year term which commenced on 1 August 2005.

19. CBSC employees are employed by JTAI and PHG. The JTAI and PHG agreements and their accompanying schedules contain all the conditions of employment.

20. CBSC employees will be deployed to PNG as long term international advisers.

21. CBSC employees are expected to be posted for more than 91 days.

22. However, JTAI and PHG 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.

23. It is anticipated that the CBSC employees will return to Australia to reside on a permanent basis on completion of their deployment.

24. The remuneration for CBSC 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 paid monthly in arrears.

25. CBSC employees are entitled to the following allowances:

- accommodation allowance; and
- living allowance.

26. All allowances are paid monthly in arrears. Allowances will be paid while a CBSC employee is on leave accrued during the deployment period.

27. CBSC employees will accrue 30 days of recreation leave per year. They will also accrue 10 days of sick leave per year.

28. Leave will be taken only with the prior written consent of the Service Centre Director. All leave must be taken prior to the termination date of the agreement.

29. It is expected that only recreation leave accrued while on deployment will be taken by CBSC employees. If an employee chooses to return to Australia on recreation leave they would not be expected or required to perform any work related duties in Australia.

30. Clause 12.1 of the Annex to the Government Treaty grants Australian personnel, including CBSC employees deployed to PNG an exemption from PNG income tax or other taxes on their salaries and allowances.

Ruling

31. The salary and allowances referred to in paragraphs 24 and 25 of this Ruling, derived by CBSC employees described in paragraph 3 to 6 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 and allowances are derived from that foreign service, including payments for recreation leave that has wholly accrued from the period of service in PNG.

32. Where the salary and allowances are exempt from tax under paragraph 31 of this Ruling, they are 'foreign earnings' of the CBSC employees under subsection 23AG(7) of the ITAA 1936 and are taken into account in calculating the Australian tax on other assessable income derived by the employee (subsection 23AG(3) of the ITAA 1936).

Example

33. In the 2006-2007 income year, Daniel, an CBSC 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 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.*

34. Subsection 6-5(2) of the ITAA 1997 provides that the assessable income of a resident taxpayer includes ordinary income derived directly or indirectly from all sources, whether in or out of Australia, during the income year.

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

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

37. Section 11-15 of the ITAA 1997 lists those provisions dealing with income which may be exempt. Included in this list is section 23AG of the ITAA 1936 which deals with exempt foreign employment income.

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

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

Where a resident, being a natural person, has been engaged in foreign service for a continuous period of not less than 91 days, any foreign earnings derived by the person from that foreign service is exempt from tax.

40. The basic tests for the exemption of foreign employment income in subsection 23AG(1) of the ITAA 1936 are:

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

However, certain foreign earnings that meet these tests may not be exempt from tax (see paragraphs 71 to 77 of this Ruling).

Resident of Australia

41. The determination of a person's residency status depends on that person's circumstances and is a determination made in relation to each year of income. For further information see Taxation Ruling IT 2650. This Ruling only applies to the class of entities described in paragraphs 3 to 6 of this Ruling who remain Australian residents for tax purposes during their deployment to PNG.

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

Engaged in foreign service

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

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

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

46. Deployment of CBSC 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

47. Each CBSC 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'.

48. Should a CBSC employee depart PNG prior to the completion of 91 days of continuous service, that employee will normally be ineligible for the exemption.

49. However, in certain instances, an employee who departs 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 16 of Taxation Ruling TR 96/15).

Temporary absences forming part of a period of foreign service

50. Subsection 23AG(6) of the ITAA 1936 treats certain temporary absences from foreign service as forming part of the period of foreign service. The Commissioner's view on the application of that subsection is reflected in paragraphs 9 to 11 of TR 96/15.

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

52. '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.

53. 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.

54. During the period of deployment, CBSC employees will accrue 30 days of recreation leave per year.

55. Given the nature of the overseas deployment, it is considered that the recreation leave granted to CBSC 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.

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

56. In certain limited circumstances, breaks other than those specified in paragraph 51 of this Ruling are also taken to form part of a period of foreign service. Such breaks include weekends, public holidays, rostered days off, and days off in lieu of such, where such breaks are authorised by the terms and conditions of the deployment. However, where such breaks are used to return to Australia they must not be excessive. Where the break is excessive the period of foreign service will still not be broken if continuity of the foreign service period can be maintained by application of the rules outlined in paragraph 58 of this Ruling.

57. 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 59 to 61 of this Ruling.

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

58. In determining whether the continuity of foreign service can be maintained, the CBSC employee should consider the application of:

- the former subsections 23AG(6A) to 23AG(6E) of the ITAA 1936 if the break occurs prior to 19 December 2005. The Commissioner's view on the application of those subsections is reflected in paragraphs 14 to 16 and the accompanying examples in paragraphs 30 and 31 of TR 96/15, and the examples in paragraphs 31A and 31B of the addendum to TR 96/15; or
- subsection 23AG(6A) of the ITAA 1936 if the break occurs on or after 19 December 2005. Paragraphs 59 to 61 of this Ruling provide an explanation of this tax provision.

Alternatively, the CBSC 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

59. 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.

60. 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 CBSC 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).

61. The 1/6 legislative rule should not be confused with the one-sixth administrative test outlined at paragraphs 56 and 57 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

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

'foreign earnings' means income consisting of earnings, salary, wages, commission, bonuses or allowances, or of amounts included in a person's assessable income under Division 13A but does not include any payment, consideration or amount that:

- (a) is included in assessable income under Subdivision AA of Division 2; or
- (b) is excluded from the definition of 'eligible termination payment' in subsection 27A(1) because of paragraph (ja), (k), (ka), (m), (ma), (n) or (p) of that definition.

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

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

65. These salary and allowances which are described in paragraphs 24 and 25 of this Ruling come within the definition of 'foreign earnings' in subsection 23AG(7) of the ITAA 1936.

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

From that foreign service

67. 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.

68. In the case of allowances paid after the taxpayer returns to Australia that relate to the period of foreign service, such allowances are treated as foreign earnings derived from that foreign service. Also, any advances against salary or allowances paid to the taxpayer prior to the undertaking of foreign service arising from the undertaking of that foreign service would be treated as foreign earnings from foreign service.

69. The receipt of the following allowances:

- accommodation allowance; and
- living allowance,

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

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

Certain foreign earnings not exempt

71. Subsection 23AG(2) of the ITAA 1936 provides that no exemption is available under subsection 23AG(1) of the ITAA 1936 in circumstances where an amount of foreign earnings derived from service 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)).

72. The Government Treaty is an international agreement, but it does not deal with diplomatic or consular privileges and immunities. Whilst the CBSC employees deployed under the Government Treaty receive privileges and immunities, they do not receive diplomatic or consular privileges and immunities.

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

74. Article 15(1) of the PNG agreement provides that remuneration paid to an Australian resident in respect of employment exercised in PNG may be taxable in PNG. However, such remuneration will be taxable only in Australia if the Australian resident is present in PNG for a period of 90 days or less in the PNG income year under Article 15(2).

75. Therefore, under Article 15 of the PNG agreement the income received by the CBSC employees while deployed in PNG is usually taxable in PNG. An exception applies, however, where an employee was present in PNG for 90 days or less in the PNG income year, as the employee will be taxable only in Australia.

76. Clause 12.1 of the Annex to the Government Treaty also grants Australian personnel including CBSC employees deployed to PNG, an exemption from PNG income tax or other taxes on their salaries and allowances.

77. As a result, the foreign earnings of the deployed CBSC employees are exempt from tax in PNG for a reason other than those 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

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

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

80. In calculating these amounts, any deductions that relate to the exempt income are allowed as if the exempt income was assessable income. That is, expenses which relate directly to earning income in PNG are deductible from exempt income.

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 96/15; IT 2650

Subject references:

- exempt foreign income
- exempt income
- foreign exempt employment income
- foreign income
- foreign income deductions
- foreign salary & wages
- foreign source income
- international tax
- overseas countries
- overseas employees
- overseas tax laws
- Papua New Guinea
- 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(6A)
- ITAA 1936 23AG(6B)
- ITAA 1936 23AG(6C)
- ITAA 1936 23AG(6D)
- ITAA 1936 23AG(6E)
- ITAA 1936 23AG(7)
- ITAA 1936 27A(1)
- ITAA 1936 Pt III Div 13A
- ITAA 1936 Div 2 Subdiv AA
- ITAA 1997 6-5
- ITAA 1997 6-5(2)
- ITAA 1997 6-15(2)
- ITAA 1997 11-15
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- International Tax Agreements Act 1953 Sch 29

Other references:

- Treaty on Development Co-operation between the Government of Australia and the Government of PNG

ATO references

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