


***CR 2003/88 - Income tax: Assessability of income:
Department of Finance and Administration
employees deployed to the Solomon Islands***

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Class Ruling

Income tax: Assessability of income: Department of Finance and Administration employees deployed to the Solomon Islands

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **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 laws dealt with in this Ruling are section 6-5 of the *Income Tax Assessment Act 1997* and section 23AG of the *Income Tax Assessment Act 1936* ('ITAA 1936').

Class of persons

3. The class of persons to which this Ruling applies is Department of Finance and Administration ('Finance') employees who are deployed to the Solomon Islands Economic Stabilisation Team and are residents of Australia for tax purposes.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described below at paragraphs 9 to 18 in this Ruling.

6. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:

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- (b) this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 July 2003. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 to 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by 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

9. The arrangement that is the subject of this Ruling is described below. This description of the arrangement is based on:

- application for a Class Ruling dated 26 August 2003;
- draft of proposed Terms and Conditions for deployment and remuneration of Finance officers to the Solomon Islands; and
- further information provided by the applicant.

10. As part of the Regional Assistance Mission to the Solomon Islands, the Australian Government has decided to send an Economic Stabilisation Team ('the Team') to the Solomon Islands to develop sustainable economic and budget processes for that country's Government. The initial period of deployment of the Team will be up to 16 months, but it is likely to extend beyond that period. The Team will include officers from Finance and is integral to the Australian Government's effort to provide Security, Law Enforcement and Economic Stabilisation to the Solomon Islands.

11. Finance officers will be deployed to the Team for a period specified by the Secretary of Finance ('the Secretary') and those officers will continue to be employees of Finance during that period. The period of deployment will range from 4 months (minimum) to 16 months with an average of approximately 12 months.

12. The Secretary may at any time direct an employee to return to Australia. If such a direction is given, the employee must comply with it immediately. An 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 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 Secretary.

13. Salary and other remuneration entitlements will continue to be paid to the Finance employee on a fortnightly basis during deployment and they will still be eligible for performance bonus. Salary and maximum performance bonus will be as agreed following a recent Remuneration Review.

14. Officers will also be entitled to:

- a Meals and Incidentals Allowance of \$63 per day; and
- a Hardship Allowance of \$100 per day.

These allowances are consistent with the schedule of allowances as determined by the Department of Foreign Affairs and Trade.

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15. In addition, on deployment to the Solomon Islands, the employee is entitled to a Composite Allowance made up of one off (annual) Basic Equipment Allowance and a one off (annual) Clothing Allowance. Individual employees are only entitled to these allowances once, regardless of subsequent additional deployments to the Solomon Islands or other overseas destinations. In exceptional circumstances, and at the discretion of the Secretary, officers may receive at any time additional monetary or other benefits to supplement the salary and benefits provided above.

16. All travel costs from Canberra to Honiara and return will be met by the project as will the officer's accommodation costs. Meals are the responsibility of the employees. However, a daily meals and incidental allowance is paid.

17. Each employee is entitled to a stand-down or reunion visit every 6 weeks while on deployment to the Solomon Islands, subject to agreement by the Under-Secretary of the Team. The stand-down will be for a period of up to 5 days (depending on flight availability) and is designed for personal recreation and professional purposes. The project will meet the cost of a Canberra–return economy class trip as part of this arrangement. Whilst in Australia the employee will usually be required to attend a debriefing session or conduct a presentation on the project. Allowances will not be paid while the employee is on stand-down in Australia. Alternatively the employee may use this entitlement to pay for a person to visit them in Honiara. In either circumstance, only the travel or compulsory stopover costs will be met by the project, all other costs will be the employee's responsibility.

18. Finance officers, while deployed to the Team, will not be able to take Recreation Leave. All recreation leave accrued while deployed to the Team is required to be taken by employees at the end of their deployment to the Solomon Islands.

Ruling

19. The income and allowances derived by an employee of Finance from their foreign service are exempt from income tax under section 23AG of the ITAA 1936 where the employee has been engaged in service in the Solomon Islands for a continuous period of not less than 91 days. The stand-downs do not constitute a break in the foreign service.

Explanation

20. As there is no double taxation agreement between Australia and the Solomon Islands, the taxation consequences of this arrangement need only be considered with reference to the domestic tax law of Australia.
21. Section 23AG of the ITAA 1936 provides a general exemption from income tax for the foreign earnings of an Australian resident taxpayer who works overseas for a continuous period of not less than 91 days.
22. 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.
23. The basic tests for the exemption of foreign employment income in subsection 23AG(1) are:
- the taxpayer must be a ‘resident of Australia’;
 - be engaged in ‘foreign service’;
 - for a continuous period of not less than 91 days; and
 - derive ‘foreign earnings’ from that ‘foreign service’.
24. If a Finance employee was a resident of Australia prior to their deployment, the deployment is not sufficient in itself to establish a non-Australian residence.
25. ‘Foreign service’ is defined as ‘*service in a foreign country as a holder of an office or in the capacity of an employee*’ (subsection 23AG(7)).
26. Deployment to the Team constitutes ‘foreign service’ as those employees are undertaking ‘*service in a foreign country as a holder of an office or in the capacity of an employee*’. Furthermore, 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*’.
27. A Finance employee is considered to meet the above definition of an ‘employee’.
28. Each Finance employee deployed to the Team is expected to serve continuously in the Solomon Islands for a period of at least 4 months. Therefore, these periods of ‘foreign service’ will meet the test that Australian residents working overseas must be engaged ‘for a continuous period of not less than 91 days’.

29. In respect of the employee's stand-down entitlements, subsection 23AG(6) identifies certain temporary absences from the period of foreign service that are related to foreign service and will not be taken to constitute a break in a period of foreign service. These absences include recreation leave wholly attributable to foreign service. The stand-downs are in accordance with the terms and conditions of the foreign service, are essentially for personal recreation and are attributable to, and accrue during, the periods the employee is actively engaged in that foreign service. The stand-downs therefore do not constitute a break in the foreign service.

30. Should an employee depart the Solomon Islands prior to the completion of 91 days of continuous service, that employee will normally be ineligible for the exemption.

31. In certain instances, an employee who departs the Solomon Islands 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 Taxation Ruling TR 96/15).

32. 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.

33. 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.

34. The remuneration of deployed Finance officers takes the form of an annual salary entitlement (with possible performance bonus) and the payment of various allowances.

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

36. Whilst the salary of Finance employees may be paid into Australian financial institutions in Australia, those 'earnings' are still considered '...foreign earnings'. Subsection 23AG(1) provides an implicit connection between 'foreign earnings' and 'foreign service', that is, '*any foreign earnings derived by the person from **that** foreign service is exempt from tax*'. The direct linkage of earnings to service

negates the need to consider any potential 'source' issues, notwithstanding that the source of remuneration under a normal contract of employment is generally regarded as the place where the duties are performed (*FC of T v French* (1957) 98 CLR 398).

Certain foreign earnings which are not exempt

37. The subsection 23AG(1) of the ITAA 1936 exemption from Australian tax will not apply in certain circumstances. Subsection 23AG(2) of the ITAA 1936 provides that, foreign earnings that are exempt from tax overseas will also be exempt in Australia except where they are exempt only because of any of the following:

- a double tax agreement or a law of a country that gives effect to such an agreement (paragraphs 23AG(2)(a) and (b));
- the law of a foreign country 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)); or
- a law or international agreement dealing with privileges and immunities of diplomats or consuls or of persons connected with international organisations applies (paragraphs 23AG(2)(e)(f) and (g)).

38. The privileges and immunities of persons connected with an international organisation do not apply to the situation in the Solomon Islands.

39. The foreign earnings derived by Finance employees in the Solomon Islands are not caught by subsection 23AG(2) as employee earnings are not exempt, under a general provision from income tax in the Solomon Islands.

Application of the section 23AG of the ITAA 1936 exemption to specific attributes of the arrangement (outlined in paragraphs 10 to 18)

Annual salary upon deployment to the Team

40. The annual salary paid to an employee for service while deployed to the Team is exempt from income tax where the employee has been engaged in service in the Solomon Islands for a continuous period of not less than 91 days. Salary paid for recreation leave accrued while on deployment to the Team during the period of 91 continuous days or more foreign service is exempt from income tax as it is derived from the foreign service.

Performance bonus

41. Any performance bonus is exempt from income tax to the extent that it is derived by a Finance employee from their foreign service where the foreign service is for a continuous period of not less than 91 days.

Meals and Incidentals Allowance and Hardship Allowance

42. The Meals and Incidentals Allowance and the Hardship Allowance paid to an employee while deployed to the Team will be exempt from income tax where the employee has been engaged in service in the Solomon Islands for a continuous period of not less than 91 days.

Composite Allowance upon deployment

43. The Composite Allowance entitlement is payable to the Finance employee on deployment to the Solomon Islands. Composite allowance paid to an employee for service while deployed to the Team is exempt from income tax where the employee has been engaged in service in the Solomon Islands for a continuous period of not less than 91 days.

Accommodation and travel

44. Accommodation and travel provided to an employee deployed to the Team will be free from tax.

General Deductions

45. The exempt income is taken into account in calculating the tax payable on non-exempt income. When this occurs, 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 the Solomon Islands are deductible from exempt income.

Other considerations

46. The tax payable on non-exempt income is calculated by using the notional average rate of tax payable (including the Medicare levy and Medicare levy surcharge but excluding any tax offsets) on the sum of the exempt income and non-exempt income. That is, for the purposes of calculating the tax payable on the non-exempt income, the exempt income is treated as if it was assessable income.

Example

47. In the 2003 - 2004 income year, Daniel, a Finance employee derived the following types of income:

- Australian employment income after deductions of \$45,000; and
- Overseas employment income after deductions of \$15,000.

The total amount of Australian tax payable on Daniel's income 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 \$60,000
(\$45,000 + \$15,000)

Step 2

The ***notional gross tax*** is \$16,032 (the normal Australian income tax and Medicare levy payable on a taxable income of \$60,000 – this does not include Medicare levy surcharge as Daniel has appropriate private patient hospital cover).

Step 3

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

Step 4

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

$$(\$16,032 / \$60,000) \times \$45,000 = \$12,024.00$$

Detailed contents list

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Commissioner of Taxation8 October 2003

Previous draft:

Not previously released in draft form.

Subject references:

- exempt foreign income

*Related Rulings/Determinations:*CR 2001/1, TR 97/16, TR 96/15,
TR 92/20, TR 92/1*Legislative references:*- ITAA 1997 6-5
- 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(7)
- ITAA 1936 Subdiv AA Div 2
- ITAA 1936 27A(1)

- TAA 1953 Pt IVAAA
- Copyright Act 1968

Case references:

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

ATO references
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