



CR 2003/94 - Income tax: Assessability of income: Members of the Australian Defence Forces (ADF) and Australian Public Service (APS) employees of the Department of Defence working in the Solomon Islands as part of operation ANODE

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Class Ruling

Income tax: Assessability of income:
Members of the Australian Defence Forces (ADF) and Australian Public Service (APS) employees of the Department of Defence working in the Solomon Islands as part of operation ANODE

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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.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

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 applies to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law that is dealt with in this ruling is section 23AG of the *Income Tax Assessment Act 1936* (ITAA 1936).

Class of persons

3. The class of persons to which this ruling applies are members of the Australian Defence Force (ADF) deployed to the Solomon Islands as part of the Operation ANODE and APS employees of the Department of Defence employed in the Solomon Islands in support

of Operation ANODE who remain residents of Australia throughout their period of deployment or employment in the Solomon Islands.

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 described below at paragraphs 9 to 20 is carried out in accordance with the details of the arrangement provided in this Ruling.
6. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:
 - 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

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 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 the Ruling is described below. This description is based on the following documents. 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 a class ruling dated 18 September 2003; and
- Defence Service Conditions Message PERS DSC 094/03 dated 1 August 2003.

Mission

10. ADF members will be deployed to the Solomon Islands as part of Operation ANODE and employees of the Department of Defence will be employed in the Solomon Islands in support of Operation ANODE on the Regional Assistance Mission Solomon Islands (RAMSI). This assistance will be through the provision of armed security forces and logistic support. To achieve this objective, ADF personnel will be deployed throughout the Solomon Islands archipelago on both land and sea. The force will be commanded by a joint headquarters and comprise RAN ships and helicopters, Army helicopters, combat and support troops, and RAAF aircraft and ground support elements.

Period of Deployment

11. The ADF will be engaged for a period specified by the Chief of the Defence Force and is expected to generally be four months in duration.

12. The ADF personnel will be engaged in a pre-deployment training program of up to one week duration before embarkation. In the majority of instances, the training program will be conducted immediately prior to deployment overseas.

Naval Concept of Operations

13. The naval contingent deployed from Australia will operate for the duration of their deployment in the Solomon Islands territorial

waters. Their tasks include: the provision of a naval presence in the Solomon Islands to reinforce the authority of RAMSI, sea transport of police and supporting ADF troops around the Solomon Islands (but within its territorial seas), maritime patrol and surveillance within Solomon Islands' territorial seas, including interdiction of boats involved in illegal trafficking of weapons and other contraband and provision of hospital and helicopter aero medical evacuation support to RAMSI.

14. The naval vessels are being resupplied in Honiara through Defence logistics support arrangements. The vessels are not expected to operate in international waters, except when their mission is complete and they return to Australia.

ADF Members - Allowances and Conditions

15. ADF members will continue to receive their annual salary according to their rank and skill set in accordance with the Defence Force Remuneration Tribunal rulings.

16. ADF members who deploy are entitled to receive Deployment Allowance currently set at \$55.50 per day. This allowance may vary in line with the level of assessed threat as determined by the Defence Intelligence Organisation and approved by the Minister Assisting the Minister for Defence (MADEF). Other allowances that may be payable include the following:

- Flight Duties Allowance;
- Service Allowance;
- Field Allowance;
- Separation Allowance;
- Seagoing Allowance;
- Hard Lying Allowance;
- Special Action Forces Allowance;
- Special Operations Allowance;
- Flying Allowance;
- Paratrooper Allowance; and
- Travelling Allowance (when meals are not provided).

17. ADF members will accrue Recreation Leave at the rate of 20 days per year. Additional Recreation Leave is also accrued for service in the Solomon Islands at the rate of 10 days per year on a pro rata basis.

Defence APS Employees – Allowances and Conditions

18. APS employees will continue to receive their annual salary according to their classification as set in accordance with the Defence Employees Certified Agreement.

19. APS officers who are employed in the Solomon Islands in support of Operation ANODE are entitled to receive Operational Support Allowance. The daily rate of the allowance is

- Weekdays - \$124.00; and
- Weekends or public holidays - \$209.00.

20. APS officers employed in the Solomon Islands in support of Operation ANODE are entitled to receive additional annual leave at the rate of two weeks a year for duty in the operational area and 0.2 weeks for every 10 days the employee is entitled to receive Operation Support Allowance, to a maximum of two weeks a year.

Ruling

21. The income and allowances referred to in paragraphs 15 to 20 derived by members of the ADF deployed to the Solomon Islands as part of Operation ANODE and APS employees of the Department of Defence employed in the Solomon Islands in support of Operation ANODE are exempt from income tax under section 23AG of the ITAA 1936 where the member or employee has been engaged in service in the Solomon Islands for a continuous period of not less than 91 days. This includes any service in relation to Operation ANODE on naval vessels within the territorial waters of the Solomon Islands.

Explanation

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

23. 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.’

24. 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'.

25. However, certain foreign earnings that meet these tests may not be exempt (see paragraphs 49-52).

Resident of Australia

26. The determination of a person's residency status depends on that person's circumstances and is a determination made in relation to each year of income. For further information, see *Income Tax Ruling* IT 2650. It is expected that persons who are deployed to the Solomon Islands on operation ANODE will remain residents of Australia throughout the period of their deployment.

Engaged in Foreign Service

27. '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)).

28. 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*'.

29. ADF members and Defence APS employees are considered to meet the above definition of 'employee'.

Land based operations

30. Service in the Solomon Islands as part of or in support of Operation ANODE on land based operations constitutes 'foreign service' as the ADF members and the Defence APS employees are undertaking '*service in a foreign country as a holder of an office or in the capacity of an employee*'.

Operations in the territorial waters of the Solomon Islands

31. Territorial waters are a part of the sea which belongs to a political entity over which that political entity can exercise its political jurisdiction (e.g. to levy income tax etc). The term country does not extend to an ocean or region of the sea that does not belong to a

political entity (see *Chaudhri v. Commissioner of Taxation*¹ (*Chaudhri's case*)).

32. Under commonly accepted international custom and international law, the geographical limits of a recognised political entity or sovereign state are not confined to the expanse of land representing the foreign country but include the recognised territorial waters of that entity. In this context, the Federal Court in *Chaudhri's case* referred to the 'political entity' when referring to foreign country. This construction of foreign country goes to the heart of the taxing rights of that country with respect to any income derived in that country. The Court in that case held:

'In our opinion, s 23AG(3) does suggest that whatever the word 'country' may mean it contemplates some unit, to use a neutral word, capable of imposing a law of income tax - or in other words, a political entity or, perhaps, part of a political entity. That is reinforced by the terms of the present s 23AG(2), which likewise suggests that it be a political entity capable of legislating.'²

33. Under the domestic legislation of the Solomon Islands and in accordance with the 1982 United Nations Convention on the Law of the Sea, the territorial waters that form part of the political entity that is known as the Solomon Islands extend twelve (12) nautical miles from its coastline, except where the median line between the Solomon Islands and the sovereign State of Papua New Guinea is less than twelve miles in which case the outermost limits of the territorial waters of Solomon Islands shall be those declared by the relevant Minister of Solomon Islands by order published in the Gazette. Therefore the political entity, and the 'country' for the purposes of section 23AG, would extend to these declared limits.

34. It is accepted that the ADF naval contingent will be deployed in the territorial waters of the Solomon Islands. It follows that ADF members who serve in that ADF naval contingent are engaged in 'foreign service' in a foreign country.

For a continuous period of not less than 91 days

35. All ADF members deployed to the Solomon Islands as part of Operation ANODE and APS employees of the Department of Defence employed in the Solomon Islands are expected to serve continuously in the Solomon Islands for a period of four months. These periods of 'foreign service', if met, meet the test that Australian residents

¹ *Chaudhri v. Commissioner of Taxation* [2001] FCA 554 (15 May 2001) at paragraph 29; 2001 ATC 4214 at 4219 to 4220; (2001) 47 ATR 126 at 132

² *Chaudhri v. Commissioner of Taxation* [2001] FCA 554 (15 May 2001) at paragraph 26; 2001 ATC 4214 at 4219; (2001) 47 ATR 126 at 131

working overseas must be engaged 'for a continuous period of not less than 91 days'.

36. Should an ADF member or Defence APS employee depart the Solomon Islands prior to the completion of 91 days of continuous service, that member or employee will normally be ineligible for the exemption.

37. In certain circumstances, a member or 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).

Temporary Absences

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

39. 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.

40. Where an ADF member or Defence APS employee is temporarily absent from foreign service due to any of the absences mentioned above in paragraph 38, these absences will be taken to form part of the period of foreign service.

Foreign Earnings

41. 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.

42. 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.

43. The remuneration of ADF members and Defence APS employees takes the form of an annual salary entitlement and the payment of various allowances.

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

45. Whilst the salary of ADF members and Defence APS employees may be paid into Australian financial institutions in Australia, those 'earnings' are still considered to be '...foreign earnings'.

From that foreign service

46. However, to qualify for the exemption the 'foreign earnings' must be derived from that '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.

47. 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 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.

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

Certain foreign earnings not exempt

49. Subsection 23AG(2) provides that no exemption is available under subsection 23AG(1) in circumstances where an amount of foreign earnings derived in a foreign country is exempt from tax in the foreign country solely because of:

- a double tax agreement or a law of a country that gives effect to such an agreement (paragraphs 23AG(2)(a) and (b));

- a law of that foreign country which generally exempts from, or does not provide for, the imposition of income tax on income derived in the capacity of an employee, income from personal services or any other similar income (paragraphs 23AG(2)(c) and (d)); and
- a law or international agreement dealing with privileges and immunities of diplomats or consuls or of persons connected with international organisations (paragraphs 23AG(2)(e)(f) and (g)).

50. There is no double taxation agreement between Australia and the Solomon Islands.

51. The foreign earnings derived by ADF members and Defence APS employees in the Solomon Islands are not generally exempt from income tax in the Solomon Islands.

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

Other relevant information

53. The 'foreign earnings' of ADF members and Defence APS employees that are exempt from Australian tax under section 23AG are nevertheless taken into account in calculating the Australian tax on other assessable income derived by the members and employees.

54. Tax will be calculated by applying to the non-exempt income (e.g. Australian salary, investment income), the notional average rate of tax payable on the sum of exempt income and non-exempt income.

Example

55. In the 2003 - 2004 income year, an ADF member derived the following types of income:

- Australian employment income of \$45,000; and
- Foreign exempt employment income of \$15,000.

Assume that the taxpayer has one or more dependants and has appropriate private patient hospital cover for Medicare levy surcharge purposes.

The total amount of Australian tax payable on the employee's income will be calculated with reference to the following formula:

$$\frac{\text{Notional gross tax}}{\text{Notional gross taxable income}} \times \text{Other taxable income}$$

Step 1

The employee's *notional gross taxable income* is \$60,000 (\$45,000 + \$15,000)

Step 2

The *notional gross tax* is \$16,030 (the normal Australian income tax \$15,580 and Medicare levy \$450 payable on a taxable income of \$60,000).

Step 3

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

Step 4

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

$$\frac{\$16,030}{\$60,000} \times \$45,000 = \$12,022.50$$

Note: An ADF member with one or more dependants as in the example will pay the Medicare levy at the rate of 0.75%. An ADF member with no dependents for Medicare purposes will not be required to pay the Medicare levy. A Defence APS employee will pay the Medicare levy at the rate of 1.5%.

Detailed contents list

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Commissioner of Taxation

22 October 2003

<i>Previous draft:</i>	- foreign Source Income
Not previously issued in draft form	- International Tax
	- overseas Countries
	- overseas Tax Laws
	- residence of Individuals
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<i>Related Rulings/Determinations:</i>	
CR 2001/1; TR 92/1; TR 92/20;	
TR 96/15; TR 97/16; IT 2650	
<i>Subject references:</i>	<i>Legislative references:</i>
- foreign Income	- ITAA 1936 23AG
- foreign Salary & Wages	- ITAA 1936 23AG(1)
	- ITAA 1936 23AG(2)
	- ITAA 1936 23AG(2)(a)

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- ITAA 1936 23AG(7)
- ITAA 1936 27A(1)
- ITAA 1936 27A(1)(ja)
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- ITAA 1936 27A(1)(ka)

- ITAA 1936 27A(1)(m)
- ITAA 1936 27A(1)(ma)
- ITAA 1936 27A(1)(n)
- ITAA 1936 27A(1)(p)
- TAA 1953 Part IVAAA
- Copyright Act 1968

Case references:

- Chaudhri v. Commissioner of
Taxation [2001] FCA 554
(15 May 2001); 2001 ATC 4214;
(2001) 47 ATR 126

ATO references

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