



CR 2004/85 - Income tax: exempt income: contractors to the Khanong Development Group working in the Lao People's Democratic Republic (Laos)

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 March 2003*



Class Ruling

Income tax: exempt income: contractors to the Khanong Development Group working in the Lao People's Democratic Republic (Laos)

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are sections 23AF and section 160AF of the *Income Tax Assessment Act 1936* (ITAA 1936) and section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies are Australian resident individuals contracted by Khanong Development Group (KDG) in relation to Phase 2 of a project to provide Engineering, Procurement and Construction Management services (the project) by KDG to Lane Xang Minerals Limited (LXML) in relation to the LXML Copper Processing Plant and Gold Plant Expansion in Laos.

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 in paragraphs 9 to 16.

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

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- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 March 2003. 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the Gazette;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Arrangement

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

- application for Class Ruling dated 29 September 2003;
- correspondence from the Australian Trade Commission (Austrade) to KDG dated 27 February 2003 confirming approved project status for the project for the purposes of section 23AF of the ITAA 1936 (Approved Project Number 2003/12); and
- further information provided by the applicant.

10. KDG is an unincorporated joint venture between Ausenco International Pty Ltd and Bateman Engineering Pty Ltd formed on 11 December 2002 for the purpose of undertaking Phase 2 of the project involving the development of copper resources and associated infrastructure at the Khanong deposit in Laos being operated by LXML.

11. The project has been granted 'approved project status' for the period March 2003 to March 2005 by the Minister for Trade under subsection 23AF(11) of the ITAA 1936.

12. KDG has contracted Australian residents (the contractors) to perform personal services on the project in Laos.

13. The contractors are not employees of KDG.

14. The contractors are paid an hourly rate in respect of services provided to the project.

15. Income derived by the contractors from services provided in Laos is taxed in Laos.

16. Contractors work in Laos on the project for between 70 and 84 hours per week. Site rotation cycles are six weeks on and two weeks off including travel time. During the two weeks off cycle, contractors are not required to return to Australia or to attend the company offices

Ruling

17. The income referred to at paragraph 14 of this ruling, derived by a contractor described at paragraph 3 of this ruling who works in Laos on the project, is exempt from income tax under subsection 23AF(1) of the ITAA 1936 where:

- the project is an eligible project (that is the approval for the project has not expired or been withdrawn by the Minister for Trade);
- the contractor has been engaged on qualifying service in Laos for a continuous period of not less than 91 days; and
- the income is attributable to that qualifying service.

18. Where a contractor has not been engaged on qualifying service in Laos for a continuous period of at least 91 days, the gross income derived by the contractor from that service is assessable under subsection 6-5(2) of the ITAA 1997. The contractor will be entitled to a foreign tax credit calculated in accordance with subsection 160AF(1) of the ITAA 1936 where:

- the contractor has paid foreign tax in respect of that income; and
- the contractor was personally liable for that tax.

Explanation

19. A payment or other benefit received by a taxpayer is assessable income if it is:

- income in the ordinary sense of the word (ordinary income); or
- an amount or benefit that through the operation of the provisions of the tax law is included in assessable income (statutory income).

Ordinary income

20. Subsection 6-5(1) of the ITAA 1997 provides that assessable income includes income according to ordinary concepts (ordinary income).

21. Payments made by KDG to the contractors are considered to be ordinary income.

22. Subsection 6-5(2) of the ITAA 1997 further provides that the assessable income of an Australian resident will include the ordinary income derived directly or indirectly from all sources, whether in or out of Australia, during the income year.

23. The determination of a person's residency status depends on their own circumstances and is a determination made in relation to each year of income. For further information, see Taxation Ruling IT 2650. This Class Ruling only applies to the class of persons who remain Australian residents for taxation purposes during the posting period in Laos.

24. Subsection 6-15(2) of the ITAA 1997 provides that if an amount is exempt income, it is not assessable income. Exempt income is that which is made exempt from income tax by a provision of the ITAA 1997 or another Commonwealth law (section 6-20 of the ITAA 1997).

25. Section 11-15 of the ITAA 1997 lists provisions that make income exempt if it is derived by certain entities. Included in that list is section 23AF of the ITAA 1936.

26. Section 23AF provides that where a natural person is engaged on qualifying service on a particular approved project for a continuous period of not less than 91 days, any eligible foreign remuneration derived by the person from that qualifying service is exempt from tax.

Eligible foreign remuneration

27. Subsection 23AF(18) of the ITAA 1936 defines 'eligible foreign remuneration'. The definition refers to income that is directly attributable to qualifying service by a resident individual on an approved project. The income referred to in paragraph 14 is income derived under a contract that is wholly or substantially for the personal services of the contractor.

28. Subsection 23AF(17) of the ITAA 1936 excludes the following types of income from being eligible foreign remuneration:

- income from overseas employment that is exempt from Australian tax due to the application of section 23AG;
- income from a superannuation, termination of employment or kindred payment or, an amount that is excluded from the definition of eligible termination payment;
- income that is derived in a foreign country and is exempt from income tax in that country but would not have been exempt if not for the operation of a double tax agreement;
- payments in lieu of long service leave; or
- payment by way of superannuation or pension.

The payments to the contractors described in paragraph 14 are not income of the type excluded by subsection 23AF(17) of the ITAA 1936.

29. Only that amount of income derived by a person from qualifying service that the Commissioner considers is reasonable will be eligible foreign remuneration (subsection 23AF(10) of the ITAA 1936). The excess is not eligible for exemption under section 23AF.

30. The income referred to in paragraph 14 of this ruling derived by the contractors is eligible foreign remuneration.

Qualifying service

31. Subsection 23AF(3) of the ITAA 1936 provides that a person shall be taken to be engaged on qualifying service on an approved project during any of the following periods during which the person:

- (a) is outside Australia and engaged in performing services on the project, including days within those periods when, as a normal incidence of work arrangements, the person is not actually performing

services on the project (for example weekends, public holidays and equivalent time-off);

- (b) is travelling between Australia and the project site, provided the Commissioner considers the time taken for the journey is reasonable;
- (c) is absent from work due to accident or illness occurring while the person was on qualifying service as described in (a) or (b); or
- (d) is on leave, other than long service leave, that accrued while the person was engaged in qualifying service on the project, whether or not taken in Australia.

32. Taxation Ruling IT 2015 refers to a situation where employees are engaged in uninterrupted cycles of five weeks on site on an onshore oil drilling project and five weeks leave in Australia, without any entitlement for additional annual leave, and who are not required to attend the company offices in Australia during leave periods. IT 2015 provides that the offsite time spent in Australia is leave to which paragraph 23AF(3)(d) applies.

33. Contractors deployed to the project work between 70 and 84 hours per week, with site rotation cycles being six weeks on and two weeks off. As the contractors' circumstances are similar to that described in IT 2015, the periods of leave taken by the contractors under the cyclical arrangement are taken to be qualifying service.

Continuous period

34. If during the period of qualifying service, a person returns to Australia for an intervening period of short duration, for reasons other than those mentioned in paragraph 32 (and therefore not engaged in qualifying service), the person may remain eligible for exemption from Australian tax on the income derived from the approved project.

35. Provided that the number of intervening days spent in Australia does not exceed one-sixth of the number of days engaged on qualifying service on the approved project, the continuity of the period of qualifying service will not be broken. However, the number of these intervening days spent in Australia will not count as days of qualifying service on the project.(see subsection 23AF(8)).

Unforeseen circumstances

36. Where a person ceases to be engaged on qualifying service in relation to an approved project because of unforeseen circumstances, the period of qualifying service of that person will include the period during which the person would, in the opinion of the Commissioner, have continued to be engaged on qualifying service but for those circumstances (subsection 23AF(6) of the ITAA 1936).

37. However, only the eligible foreign remuneration derived from the period of qualifying service completed before the cessation due to unforeseen circumstances is eligible for exemption under section 23AF.

Substituted person

38. If a person (the substituted person) replaces another person engaged by KDG whose qualifying service was prematurely terminated for unforeseen reasons, special rules apply to work out the qualifying service period of the substituted person.

39. The substituted person's period of qualifying service will include the period of the person originally assigned to the project and the period in which they were actually engaged on the project. If the sum of these periods is not less than 91 days, the substituted person will be eligible for the exemption (subsection 23AF(7) of the ITAA 1936).

40. It is only the eligible foreign remuneration that the substituted person derives from qualifying service that commenced from the time when the substitution commences that will be exempt.

Period of qualifying service less than 91 days

41. Where the period of continuous qualifying service completed by a contractor is less than 91 days, the income derived from that service is not exempt under section 23AF. Persons that fall into this category must include the gross amount of the foreign earnings derived from the project as assessable income in their Australian tax return.

42. Where foreign tax has been paid in Laos in relation to the assessable foreign earnings, a foreign tax credit will be available.

43. Subsection 160AF(1) of the ITAA 1936 provides that a resident taxpayer, whose assessable income includes foreign income on which the taxpayer has paid foreign tax, for which the taxpayer was personally liable, is entitled to a credit against the Australian tax payable of the lesser of:

- the amount of that foreign tax paid, reduced in accordance with any relief available to the taxpayer under the law relating to that tax; or
- the amount of Australian tax payable in respect of the foreign income.

44. Subsection 6AB(2) of the ITAA 1936 defines 'foreign tax' to include tax imposed on income by a law of a foreign country.

45. Tax imposed by the Laos Government on income derived by the contractors in relation to the project is a 'foreign tax' for the purposes of subsection 6AB(2) of the ITAA 1936. Accordingly, where a contractor is required to include income referred to in paragraph 14 of this ruling in their Australian tax return, a foreign tax credit will be allowable under subsection 160AF(1) of the ITAA 1936 where Laos tax has been paid by the contractor in respect of that income.

Exempt 23AF income and other income

46. The eligible foreign remuneration of the contractors that are exempt from Australian tax under section 23AF are nevertheless taken into account in calculating the Australian tax on other assessable income derived by the employee (subsection 23AF(17A) of the ITAA 1936).

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

48. 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 Laos are deductible from exempt income.

Example

49. In the 2003-2004 income year, a contractor derives the following types of income:

- Australian business income of \$45,000;
- Foreign exempt business income of \$15,100; and
- Expenses directly related to foreign exempt business income of \$100.

Assume that the contractor 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:

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

Step 1

The contractor's **notional gross taxable income** is \$60,000 (\$45,000 + \$15,100 – \$100).

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).

Step 3

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

Step 4

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

$$\begin{aligned} & \frac{\$16,032}{\$60,000} \times \$45,000 \\ & = \$12,024.00 \end{aligned}$$

Detailed contents list

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Commissioner of Taxation
18 August 2004

<i>Previous draft:</i>	- TAA 1953 Pt IVAAA
Not previously issued as a draft	- ITAA 1936 6AB(2)
	- ITAA 1936 23AF
<i>Related Rulings/Determinations:</i>	- ITAA 1936 23AF(3)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 23AF(3)(d)
TR 97/16; IT 2015; IT 2650	- ITAA 1936 23AF(6)
	- ITAA 1936 23AF(7)
	- ITAA 1936 23AF(10)
<i>Subject references:</i>	- ITAA 1936 23AF(11)
- approved overseas project	- ITAA 1936 23AF(17)
- exempt income	- ITAA 1936 23AF(17A)
- foreign income	- ITAA 1936 23AF(18)
- foreign source income	- ITAA 1936 23AG
- foreign tax credit	- ITAA 1936 160AF(1)
- international tax	- ITAA 1997 6-5
- Laos	- ITAA 1997 6-5(1)
- overseas countries	- ITAA 1997 6-5(2)
- overseas tax laws	- ITAA 1997 6-15(2)
	- ITAA 1997 6-20
<i>Legislative references:</i>	- ITAA 1997 11-15
- Copyright Act 1968	

ATO references

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