


TD 93/D176 - Income tax: exemption with progression: how are deductions for superannuation contributions and tax agents fees to be treated when a taxpayer has exempt foreign earnings under section 23AF or section 23AG of the Income Tax Assessment Act 1936 and other income?

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This document has been finalised by TD 95/36.

Draft Taxation Determinations (TDs) represent the preliminary, though considered, views of the ATO. Draft TDs may not be relied on; only final TDs are authoritative statements of the ATO.

Draft Taxation Determination

Income tax: exemption with progression: how are deductions for superannuation contributions and tax agents fees to be treated when a taxpayer has exempt foreign earnings under section 23AF or section 23AG of the *Income Tax Assessment Act 1936* and other income?

1. Deductions for superannuation contributions and tax agents fees should be apportioned between exempt foreign earnings and assessable income on the same basis as 'apportionable deductions' when determining the taxpayer's 'Other taxable income'.
2. Subsections 23AF(17A) and 23AG(3) contain the same formula for calculating the tax payable on taxable income in cases where a taxpayer has exempt foreign earnings and other income (exemption with progression). The purpose of exemption with progression is to ensure that taxpayers with foreign earnings that are exempt from Australian tax under sections 23AF or 23AG are levied a similar rate of tax on their non-exempt income as taxpayers earning the same overall income from assessable sources. In the absence of exemption with progression a taxpayer with exempt foreign earnings and assessable income would have the advantage of lower marginal tax rates and the full amount of concessional deductions to significantly reduce Australian tax compared with a taxpayer earning the same overall income from Australian sources.
3. Basically this is achieved, under the exemption with progression formula, by calculating the average rate of tax that the taxpayer would have paid if the exempt foreign earnings were not exempt. That notional average rate is then applied to the taxable amount of the taxpayer's non-exempt income (called 'Other taxable income') to arrive at tax payable.
4. When calculating the 'Other taxable income' to which the notional average rate is applied it is necessary under the definition of that term in subsections 23AF(17A) and 23AG(3) to deduct from the amount of the taxpayer's other income that is assessable income:
 - (d) any deductions allowable to the taxpayer in relation to the year of income that relate exclusively to that assessable income; and
 - (e) so much of any other deductions (other than apportionable deductions) allowable to the taxpayer in relation to the year of income as, in the opinion of the Commissioner, may be appropriately related to that assessable income; and
 - (f) the amount calculated using the formula in subsection 23AF(17B)/23AG(4). (this formula apportions 'apportionable deductions' between exempt and non-exempt income)

5. Superannuation contributions and tax agent fees are not considered to relate exclusively to either the production of assessable income or the exempt foreign earnings for these purposes and they are not 'apportionable deductions' as defined in subsection 6(1). It follows that those deductions are to be taken into account under paragraph (e). In that regard, conceptual and practical considerations require that the extent to which they may be appropriately related to the taxpayer's assessable income be determined in the same manner as is prescribed in subsections 23AF(17B) and 23AG(4) for apportionable deductions.

Example:

A taxpayer has the following income and deductions:

	<u>Gross income</u>	<u>Deductions directly related [eg. ss.51(1)]</u>	<u>Net income</u>
	\$	\$	\$
Exempt foreign earnings	25,000	1,000	24,000
Rental income	5,200	4,200	1,000
Australian salary	30,200	200	<u>30,000</u>
			55,000

Other deductions: superannuation contributions (3,000); tax agent fees (400); and gifts (100). Notional gross taxable income is therefore \$51,500.

'Other taxable income' is:

Gross rental income and Australian salary		35,400
less expenses directly related to that income [para. d]	4,200	
	200	
less deductions that have been apportioned [paras. (e) & (f)]*	<u>1,973</u>	<u>5,973</u>
Other taxable income		<u>29,027</u>

* Calculation of amount of superannuation contributions, tax agent fees and gifts deductions to be treated as deductible from the taxpayer's assessable income for the purposes of paragraphs (e) and (f) of the definition of 'Other taxable income' in subsections 23AF(17A) and 23AG(3):

$$\begin{array}{l} \text{total deductions} \\ \text{subject to} \\ \text{apportionment} \\ (3,500) \end{array} \times \frac{\begin{array}{l} \text{other taxable income} \\ \text{(ignoring deductions subject to apportionment) (31,000)} \\ \text{notional gross taxable income (51,500) + deductions subject to} \\ \text{apportionment (3,500)} \end{array}}{\begin{array}{l} \text{notional gross taxable income (51,500) + deductions subject to} \\ \text{apportionment (3,500)} \end{array}} = 1,973$$

Commissioner of Taxation

8/7/93

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Related Determinations:

Related Rulings:

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