House of Representatives Standing Committee on Infrastructure, Transport, Regional Development & Local Government

Inquiry into Coastal Shipping Policy and Regulation

Treasury views on what impacts could be expected if the Committee was to recommend either of the following suggested changes to income taxation:

- *Amending section 23AG to ensure that Australian nationals are not disadvantaged by being denied access to concessionary taxation arrangements when on the high seas; and*
- *Allowing for an international vessel to be deemed to be a project for the purposes of section 23AF (which sees similar concessions available for consultants and contractors working overseas).*

General Position

Treasury notes the expected policy outcomes from the proposed recommendations are not clear, and makes the following observations:

- a defined outlays program generally provides a less distortionary and more transparent means of providing targeted assistance;
- implementation of the recommendations would:
  - introduce additional inequities into the tax system;
  - provide a concessionary treatment for international seafarers that is not available to seafarers plying the coastal trade, involving:
    - a windfall gain to some taxpayers;
    - a relative disincentive to working in the domestic shipping sector; and
  - involve a cost to revenue.

Treasury considers the delivery of concessionary treatment for international seafarers may work against the primary policy objectives of this Committee to recommend ways to improve Australian coastal trade and retaining a highly skilled Australian-based shipping workforce.

Proposed Recommendation 1: Section 23AG

Targeted concessions implemented through the taxation system tend to institutionalise inequities between individuals and businesses, enhancing the potential for inefficient resource allocation. They also tend to increase compliance costs as a result of legislative complexity and enhanced administrative obligations; reduce public transparency; and, lower the likelihood of regular review of the effectiveness of such arrangements in meeting their policy intent.

Treasury would generally recommend the provision of concessionary outcomes through well-targeted expenditure programs.

However, any improvement to the after-tax income position of Australian resident international seafarers could be expected to provide a relative disincentive to working in the domestic shipping

sector. Furthermore, it may distort the supply of labour from more efficient uses in other industry sectors that offer greater potential return to Australia (noting few international seafarers are employed on Australian owned or operated ships).

Treasury notes there is no clear policy outcome identified in relation to this recommendation, other than to removal a denial of access to 'concessionary taxation arrangements'.

Treasury considers section 23AG is primarily a mechanism to alleviate double taxation. It does not regard its principal role is to produce concessionary tax outcomes for those Australian taxpayers earning offshore employment income. While outcomes of this type arise – primary as a result of legislative interpretation - Treasury would not support the extension of its scope on this basis.

This section provides for outcomes that undermine a general equity objective of the tax system, that Australian residents earning the same level of income should pay the same tax. This recommendation would further undermine that objective, without a clear rationale. It would also establish a false precedent for 'special treatment' for other classes of Australian taxpayer, on the basis of concessionary outcomes.

More specifically, were the identified amendment to section 23AG to proceed, Treasury considers it would have little, if any, positive impact in relation to the objectives of this Committee.

Section 23AG provides an exemption from Australian tax in relation to income earned overseas. To the extent the effect of access to section 23AG on after-tax earnings is significant, the change would be to distort the tax outcomes between domestic seafarers and Australia resident seafarers undertaking overseas employment.

This recognises that the overseas employment income exempted from Australian tax under section 23AG may face no, or considerably lower rates of tax, in other countries. As a consequence, domestic seafarers would face a higher tax burden on the same level of income.

Implementation of the recommendation would arguably encourage domestic seafarers to undertake overseas employment, thereby diminishing both domestic labour supply and the skills base of the Australian shipping industry.

It should also be noted that as a means of providing concessionary tax outcomes for Australian resident international seafarers, as a class of taxpayer, section 23AG could not deliver a consistent outcome. The provisions are highly technical in nature, and the tax impacts difficult to determine other than on a case by case basis.

Any correlation between enhancing the attractiveness for Australia seafarers to [continue to] work overseas and building a domestic labour force is ambiguous. The general factors influencing a decision to enter maritime employment would seem more determinative (including scope for trainee placements) than the (variable) after-tax return to offshore employment income.

Similarly, it would not seem sustainable to argue that excess capacity embedded in international seafarers is a long term solution to securing a domestic labour force (that is, international seafarers would then undertake domestic shipping as opposed to any other form of employment). At a minimum, this disregards the impact of current labour price differentials applying across domestic industry sectors on work choice.

Proposed Recommendation 2: Section 23AF

Treasury notes its comments in relation to section 23AG (above).

Treasury considers the extension of the concept of overseas project to an 'international vessel' to be inconsistent with the policy objective, legislative framework and current administration of this section, which involves national interest considerations.

Beyond an objective to provide a concessionary tax outcome for a special class of taxpayer, it is difficult to identify the national interest case in relation to what would be mainly foreign owned and operated ships engaged in private commercial activity.

In addition, section 23AF predominately applies to non-employment related personal services income. The classification of seafarers as independent contractors is a question of fact and would likely vary between cases, depending on individual circumstances. Further, the 'international vessel' may have no incentive to seek designation as an approved project (which is a pre-requisite to section 23AF applying to an independent contractor).

Consequently, in many cases, section 23AF would not operate to exempt their earnings.

Background

Under Australia's income tax system, consistent with its general approach to the taxation of individuals, Australian resident seafarers are subject to tax on their worldwide income. Foreign resident seafarers are subject to tax on their Australian sourced income.

As the taxation of foreign source income of residents may give rise to double taxation (where such income is also taxed in the foreign country), relief is typically provided either by the foreign income being made exempt from Australian tax (in this case by section 23AG or 23AF of the *Income Tax Assessment Act 1936* (ITAA 1936)) or through a credit being provided for foreign taxes paid (which subsequently reduce the Australian tax payable on the foreign income). Corresponding mechanisms apply to relieve double taxation in other countries.

Many of Australia's double tax treaties provide that where an Australian resident seafarer earns employment income from international shipping activities on a ship operated by a resident of the treaty partner, that jurisdiction may tax this income.

Section 23AG of the ITAA 1936

Section 23AG was introduced in 1986, at the same time as (and essentially carving certain income out from) the general foreign tax credit system. It provides an exemption from Australian income tax for salary and wages income earned by Australian individuals working overseas (in specified circumstances). Such income would otherwise be subject to Australian tax at the individual's marginal rate, with a credit provided for foreign tax paid. The exemption is subject to a number of conditions, including that the foreign earnings are derived from foreign service for a minimum of 91 continuous days (although allowances are made for certain types of temporary absences, provided they are not considered excessive), subject to certain conditions.

It also involves an 'exemption with progression' concept. That is, in determining the marginal tax rate an individual then faces in relation to any assessable income they have earned, consideration is given the quantum of income exempted under section 23AG.

Seafarers earning remuneration from international shipping activity do not qualify for the exemption for strict legal reasons, essentially because their foreign service occurs in international waters rather than in a foreign country. Service on a foreign ship in international waters does not constitute 'foreign service' – which is a condition of the exemption (refer *Chaudhri vs FC of T*, Full Federal Court, 2001).

However, seafarers earning remuneration from coastal shipping activities in other jurisdictions may be able to utilise section 23AG.

Section 23AF of the ITAA 1936

Section 23AF was introduced in 1980 to provide an income tax exemption (in specified circumstances) for personal services income earned by Australian individuals working on overseas projects approved by the Minister for Trade as being in the national interest. The provision encourages Australians to work on such projects and relieves double taxation in individual cases. However, it does not apply where an exemption is available under section 23AG.

The project approval process is administered by Austrade. Approval may be granted to: Australian individuals and corporations; Australian governments or their authorities; foreign governments or their authorities; and international organisations and their agencies.

The project approval criteria are:

- employment of Australians bringing tangible economic benefits to Australia;
- benefit to Australia by association of goodwill;
- existence of foreign competition for the project;
- net foreign exchange benefit accruing to Australia; and
- application for section 23AF status must precede the contract bid, to prove its importance in securing the contract.

The exemption is subject to a number of conditions, including the requirement that the foreign earnings are derived from foreign service for a minimum of 91 continuous days (although allowances are made for certain types of temporary absences, provided they are not considered excessive), subject to certain conditions.