Submission No 42

Inquiry into Australia's Maritime Strategy

Organisation: The Treasury

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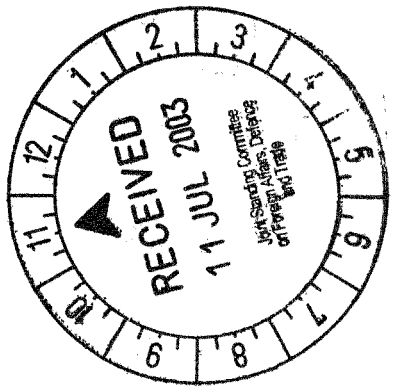

Mr Stephen Boyd
Secretary
Joint Standing Committee on Foreign Affairs, Defence and Trade
Defence Sub-Committee
Parliament House
CANBERRA ACT 2600

Dear Mr Boyd

INQUIRY INTO AUSTRALIA'S MARITIME STRATEGY - SECTION 23AG OF THE *INCOME TAX ASSESSMENT ACT 1936*

Thank you for your letter of 3 June 2003 regarding section 23AG of the *Income Tax Assessment Act 1936* ("section 23AG"). I apologise for the delay in responding to you.

You seek in your letter the reasons why Australian residents working in a foreign service but whose place of work is a ship at sea are not covered under the provisions of section 23AG.

Section 23AG provides an exemption from income tax for foreign earnings derived by an Australian resident taxpayer from at least 91 days continuous employment in a foreign country. Foreign service is defined in the legislation as 'service in a foreign country as the holder of an office or in the capacity of an employee'. As Australian seafarers working on international waters are not considered to be engaged in 'foreign service' (because they are not performing service in a foreign country), these individuals are not able to claim the income tax exemption available under section 23AG.

Section 23AG was introduced to prevent double taxation. Australian residents working in international waters, who do not have access to the section 23AG exemption, are generally not subject to foreign tax on their associated income. In any instance where they were subject to foreign tax, however, they would be eligible to receive foreign tax credits in Australia so as to prevent double taxation. As such, Australian resident seafarers need not rely on section 23AG to prevent the double taxation of their associated income.

You are also seeking advice on how section 23AG compares to the taxation legislation of other relevant countries. While we are unable to provide the sub-committee with detailed information regarding any similar provisions in place in overseas jurisdictions, I have attached an outline of the *foreign earned income exclusion* available in the United States and the *foreign earnings deduction* available in the United Kingdom.

I understand that the Commissioner of Taxation will be responding to you in relation to your request for advice summarising the current operation of section 23AG.

I trust this information will be of assistance to the sub-committee.

Yours sincerely

Martin Parkinson
Acting Secretary to the Treasury

UNITED STATES[1]

Foreign earned income exclusion

A *qualifying individual* who works abroad and receives earned income from foreign sources may elect to exclude up to $80,000 for calendar year 2002 (and thereafter) of *foreign earned income* attributable to the period of residence in a foreign country.

In relation to U.S. citizens working abroad, a qualifying individual is one who makes a *tax home* in a foreign country and meets either the *bona fide residence test* or the *physical presence test.*

The individual's tax home is his regular or principal place of business. If (s)he has no regular or principal place of business, then the tax home is generally the regular place of abode.

An individual meets the bona fide residence test where (s)he is a bona fide resident of a foreign country or countries for an uninterrupted period that includes a full tax year (brief or temporary trips elsewhere for vacations or business are permitted). However, an individual will **not** be considered to be a bona fide resident of a foreign country if (s)he files a statement of non-residency with the foreign authorities and is held exempt from such country's income tax.

The physical presence test is met where 330 full days out of any 12-consecutive-month period are spent in a foreign country (or countries).

Earned income includes wages, salaries or professional fees and any other amounts received as compensation for personal services actually rendered during the period in which the bona fide residence test or physical presence test is met.

A foreign country is usually any territory (including air space, territorial waters, sea bed and subsoil) under a government other than the United States. The term 'foreign country' includes Continental Shelf areas over which the foreign country has exclusive rights under international law to explore and exploit the natural resources.

Foreign tax credits/deduction

The U.S. also has a system of foreign tax credits/deduction in place to avoid double taxation. Individuals may choose either to deduct foreign income taxes paid or accrued or may apply them as a credit against U.S. income tax (subject to certain limitations), whichever is more favourable.

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[1] Sources: *2003 U.S. Master Tax Guide*, CCH Incorporated Chicago, 86th edition; www.irs.gov

UNITED KINGDOM[2]

Foreign earnings deduction

Up to 16 March 1998, the *foreign earnings deduction* could be claimed by all employees; after this date, it is only available to seafarers. 'Seafarers' are individuals who perform the duties of their employment on a ship (this does not include offshore installations such as mobile offshore drilling rigs).

The foreign earnings deduction provides in certain circumstances a deduction of 100 per cent from the amount of earnings chargeable. It is available where:

- The duties of the taxpayer's employment are performed wholly or partly overseas;
- The taxpayer remains resident[3] and ordinarily resident[4] in the UK while working abroad; and
- The earnings are for a period which is part of a qualifying absence lasting 365 days or more.

For this purpose, seamen are generally treated as performing their duties abroad where the voyage or any part of it begins or ends outside the UK.

A *qualifying period* is a period of consecutive days which consists of days of absence from the UK. Days spent abroad on holiday can be included towards the 365-day period.

Double tax relief

Where a double tax agreement does not provide relief from double taxation, a taxpayer may nevertheless be entitled to relief under domestic legislation. This may come in the form of a credit in calculating UK tax. Alternatively, the taxpayer may be able to treat the foreign tax paid as a deduction against taxable income.

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[2] Sources: *2002-03 CCH Tax Handbook*, Croner.CCH Group Ltd Surrey; www.inlandrevenue.gov.uk

[3] To be regarded as **resident** in the UK, the taxpayer must normally be physically present in the country at some time in the tax year. The taxpayer will always be resident if (s)he is in the UK for **183 days** or more in the tax year. Where the taxpayer is present for less than 183 days, (s)he may still be treated as resident for the year under other tests.

[4] A taxpayer who is resident in the UK year after year is treated as **ordinarily resident**.