



## Australian Shipowners Association

### Reform of the *Income Tax Assessment Act 1936*: Equal treatment for Ships' Officers

#### Why does the ITAA 1936 require amendment?

As the Act currently stands, Australians who are officers working in vessels operating in international trades are subject to Australian domestic taxation. This places them in a different tax position from both:

- Other Australians who work overseas, and
- The seafarers of many other countries with whom Australian seafarers are in competition for employment opportunities.

A consequence of this unequal treatment is that Australian seafarers suffer a cost disadvantage relative to those with whom they directly compete. This in turn leads to a reduction in employment opportunities for Australian seafarers and causes a number of negative economic impacts, including increased pressure on the current account.

A change to the Act would make an important contribution to enabling Australian maritime officers to compete in the international market place for seagoing labour on a fair and equal basis. The inequity of the current situation is highlighted when the case for change is examined in terms of:

- The tax treatment of competitors
- Comparable tax treatment across industries
- Economic Considerations.

Put simply, the effect of s.23AG of the ITAA 1936 on ships' officers was never intended; the intention to maintain the exemptions under s. 23(q) (now s.23AG) were specifically stated in the Explanatory Memorandum that accompanied the amending Bill. Ships' officers were never intended to be discriminated against vis a vis other Australian resident taxpayers that satisfy the criteria of s.23AG.

#### Tax Treatment of Australian Competitors

In practice, the majority of shipowners operating internationally can register their vessels in open registry countries and hire their crews through recruitment companies located in any country of the globe. The income tax applicable to the crews is often a factor in this decision, directly impacting on the gross wage payable by the shipowner.

Governments throughout the world have recognised this problem, and many of them have addressed it by introducing concessionary tax regimes for international seafarers (eg Denmark, Germany, Netherlands, France, Singapore, Norway, UK, Korea, Thailand, India, Indonesia, Philippines and Vietnam). The case of the Philippines is of particular importance as the Philippines is the second largest supplier (after China) of trained seafarers to the international market.

Member of the International Chamber of Shipping, International Shipping Federation, Asian Shipowners Forum, and Australian Shipping Federation

Head Office:  
Level 1, 4 Princes Street  
Port Melbourne, VIC 3207  
Telephone: +61 3 9646 0755  
Facsimile: +61 3 9646 2256  
E-mail: [admin@asa.com.au](mailto:admin@asa.com.au)  
Website: [www.asa.com.au](http://www.asa.com.au)

PO Box R506  
Royal Exchange, Sydney NSW 1225  
Level 7, 6 Underwood Street  
Sydney NSW 2000  
Telephone: +61 2 9258 8009  
Facsimile: +61 2 9241 3456

## **Comparable Tax Treatment Across Industries**

A fundamental principle of good taxation is that similarly situated taxpayers should be treated similarly. Failure to do so results not only in inequities but also in economic distortions. This is directly relevant to the proposed reform.

Comparability of tax arrangements for similarly situated taxpayers is underscored in sections 23AF and 23AG of the Act. Under Section 23AG of the Act, personal exertion earnings of Australian nationals working for extended periods in foreign countries are in general exempted from Australian income tax. One of the effects of this is that Australian nationals working in overseas jurisdictions are subject to the same income tax rules as their competitors working in that same environment. This creates an environment of competitive neutrality.

The importance of ensuring this competitively neutral environment is also recognised in Section 23AF, which provides tax concessions for employees of Australian companies working overseas on 'approved projects', so that they can compete on equal terms with their foreign competitors in those countries. This is made completely clear in official Government information packages for contracting firms:

*'The main intention of this legislation [Section 23AF] is to ensure that Australian consultants and contractors are not disadvantaged compared to other countries' firms by allowing them to operate under tax free conditions.'*

Approval of projects for concessions under Section 23AF requires that the Minister for Trade be satisfied that the project is in the national interest. National interest criteria include provisions that:

- The employment of the project will bring tangible benefits to Australia
- There is foreign competition for the project and the tax relief would make the Australian offering more competitive
- There will be a net foreign exchange benefit.

All three of the conditions apply to the case of Australian seafarers employed overseas on internationally trading vessels. It is therefore clear that the proposed change is consistent with the taxation policy that the Government is pursuing in other sectors.

Yet currently the tax treatment of Australian seafarers working outside Australia differs from that of other Australian workers such as engineers, accountants, consultants and other professionals. Seafarers are not engaged on a project, and therefore not eligible for tax relief under Section 23AF. Moreover, the Federal Court has adopted a restrictive definition of foreign service, excluding service on an internationally trading vessel determining that service on the high seas does not constitute service in a foreign country.<sup>1</sup>

## **Economic Considerations**

There are a number of long-term economic advantages to this reform measure in terms of employment, availability of skilled labour, and the balance of payments.

### **Employment**

Opportunities for Australian seafarers in the domestic shipping industry are declining. The number of seafarers employed on Australian ships declined from an estimated 5300 in 1988 to less than 2000 in 2001. Given the decline in the Australian fleet, an increasing number of

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<sup>1</sup> Chaudhri v Commissioner of Taxation [2001] FCA 554.

Australian marine officers are required to look offshore to gain valuable onboard experience and skills.

Australia currently has world class maritime officer training in institutions such as the Australian Maritime College. The excellent skills and professionalism of Australian (trained) ships' officers is universally recognised, and these attributes, together with their English language skills make them highly desirable employees overseas. However, the current Australian taxation arrangements do not allow them to compete equally with their international counterparts and they are commercially less attractive.

### **International Demand for Skilled Labour**

There is a general consensus that a global shortage of experienced maritime officers is looming. Australia's excellent maritime training programs places us in a unique position to fill a significant element of this international gap. The skills that maritime officers accrue within their first decade of maritime experience are essential for the subsequent effective operation of a wide range of land-based industries such as port operations, maritime regulation, maritime business operation and, most importantly, in defence.

Australia can ill-afford to abrogate its safety, logistics and regulatory obligations and requirements to a declining foreign skills base.

### **Balance of Payments**

The export of services is now equally as important as the export of goods in maintaining a strong current account position, but Australia has historically performed poorly in this area. There is significant untapped potential in the export of the personal services of Australian maritime officers, who will be paid in foreign currency (usually US dollars), and will repatriate a significant proportion of the earnings as resident taxpayers. This will have a positive impact on Australia's balance of payments position.

### **Fiscal Implications**

The tax inequity that this proposal is attempting to address has severely inhibited the ability of Australian maritime officers to sell their services internationally. Of those who have nevertheless taken employment on overseas ships, some have chosen to reside overseas rather than face the tax penalty of maintaining their Australian base: this of course brings with it a genuine risk that their skills and experience will be permanently lost to Australia.

The new tax system has diversified the tax base, with a greater share of total tax revenue now coming from consumption. The repatriated earnings of Australian seafarers will increase as a more competitive and more equitable tax position encourages more Australian officers to take up employment on international vessels. Insofar as this leads to an increase in aggregate consumption, it will also lead to an increase in receipts from indirect taxation.

It would be extremely difficult to quantify exactly what the overall impact of the proposed change would be on total taxation receipts, or even to determine conclusively whether it will be positive or negative. We can, however, say with confidence that the impact on Australian tax earnings will be very small.

### **Recommendation**

Amend Section 23AG(7) of the *Income Tax Assessment Act 1936 (Cth)* to reflect the intention expressed in the Explanatory Memorandum of the Bill that introduced s.23AG in 1986, that '[n]otwithstanding the repeal of paragraph 23(q), salary or wages earned overseas that is subject to tax in the country of source will continue to be fully exempt from Australian income tax...']