15 T.C. 236 (1950)

A U.S. citizen working abroad can exclude foreign-earned income from U.S. gross income if they establish bona fide residency in a foreign country for a specified period, as determined by their intent and the nature of their stay.

Summary

The Tax Court addressed whether a U.S. citizen working in Canada could exclude his Canadian-earned income from his U.S. gross income under Section 116 of the Internal Revenue Code. The court held that the taxpayer was a bona fide resident of Canada for over two years, allowing him to exclude income earned during 1943 and 1944. However, income earned in 1942 did not qualify because he wasn't a resident of Canada for the entire year. The decision hinged on the determination of "bona fide residence," considering factors such as the taxpayer's intent, the duration of his stay, and his integration into the Canadian community.

Facts

Herman Baehre, a U.S. citizen, was sent to Edmonton, Canada, by his employer, Miller Construction Co., to work on a war contract in August 1942. Initially expecting a short assignment, Baehre soon realized the project would last much longer and arranged for his family to join him. His wife and children moved to Edmonton with all their possessions, including furniture and a car, intending to reside there indefinitely. The family lived in an apartment, participated in local church and community activities, and maintained no other home. Baehre joined a Masonic lodge in Edmonton. He did not pay Canadian income taxes or apply for citizenship.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Baehre's income tax for 1943 and 1944, arguing that his Canadian earnings were taxable. Baehre contested this determination in the Tax Court, claiming he was entitled to exclude his foreign-earned income under Section 116. He also sought a refund for 1942 taxes, claiming the same exclusion. The Tax Court reviewed the evidence to determine if Baehre met the requirements for bona fide residency in Canada.

Issue(s)

Whether the compensation Herman Baehre received for services rendered in Canada during 1942, 1943, and 1944 is excludable from his taxable income under Sections 116(a)(1) and 116(a)(2) of the Internal Revenue Code, as amended by Section 148(a) of the Revenue Act of 1942, based on his residency status in Canada.

Holding

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1. Yes, the compensation received in 1943 is excludable because Baehre was a bona fide resident of Canada during the entire taxable year 1943.
2. Yes, the compensation received in 1944 is excludable because Baehre was a bona fide resident of Canada for at least two years ending October 1, 1944.
3. No, the income received in 1942 is not excludable because Baehre was not a bona fide nonresident of the United States for more than six months during that year.

Court’s Reasoning

The court determined that Baehre established a bona fide residence in Canada shortly after his arrival in August 1942, when he moved his family and belongings there with the intent of staying for an indefinite period. Key factors included his family’s relocation, participation in local community and church activities, and the absence of a home in the United States. The court likened the situation to that in *Charles F. Bouldin, 8 T.C. 959*, where similar facts led to a finding of bona fide Canadian residence. Regarding the 1942 income, the court noted that Section 116(a)(2) was intended to cover the portion of the taxable year when the taxpayer changed their residence back to the United States, and did not apply retroactively to the entire year when the residency was initially established.

Practical Implications

This case illustrates the importance of establishing bona fide residency in a foreign country to qualify for tax exclusions on foreign-earned income. It highlights that physical presence alone is insufficient; intent to reside in the foreign country, integration into the community, and the duration of the stay are all critical factors. The decision clarifies the application of Section 116(a)(2), emphasizing that it primarily applies to the year a taxpayer returns to the United States after establishing foreign residency for at least two years, allowing for proportional exclusion of income earned abroad during that return year. Later cases have relied on *Baehre* to analyze similar residency questions, emphasizing the fact-specific nature of these determinations.

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