16 T.C. 232 (1951)

A U.S. citizen working abroad may qualify for a tax exemption under Section 116(a) of the Internal Revenue Code if they establish a bona fide residence in a foreign country, considering factors such as the length and nature of their stay, intent to remain, and connections to the foreign country.

Summary

David Rose, a U.S. citizen, worked as a managing director for Paramount Pictures in the United Kingdom from 1938 to 1946. He claimed a tax exemption under Section 116(a) for income earned abroad, arguing he was a bona fide resident of the UK. The Commissioner of Internal Revenue denied the exemption, arguing he wasn't a bona fide resident. The Tax Court ruled in favor of Rose, finding he had established a bona fide residence in the UK despite periodic trips to the U.S., and was therefore entitled to the tax exemption for the years 1943-1945 and until September 30, 1946.

Facts

Rose was hired by Paramount Pictures in 1938 to manage their UK subsidiaries. A condition of his employment was that he reside in England. He moved to London with his family, leased an apartment, joined English clubs, and opened local charge accounts. Due to the war, his family returned to the U.S. in 1940, but Rose remained in England to continue his work. He made semi-annual trips to the U.S. to visit his family and confer with his employer. His family returned to England in 1945. In 1946, Rose planned a new motion picture venture, resigned from Paramount effective September 30, 1946, and returned to the U.S. permanently in November 1946.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies in Rose's income tax for the years 1943-1946. Rose petitioned the Tax Court for a redetermination of the deficiencies, arguing he was entitled to a tax exemption under Section 116(a) of the Internal Revenue Code. The Tax Court ruled in favor of Rose.

Issue(s)

Whether David Rose was a bona fide resident of Great Britain during the tax years 1943, 1944, 1945, and until September 30, 1946, and thus entitled to exclude his foreign-earned income from gross income under Section 116(a) of the Internal Revenue Code.

Holding

Yes, because Rose established a bona fide residence in Great Britain based on the nature and length of his stay, the purpose of his presence there, and his intent to

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remain in England for an indefinite period to fulfill his employment obligations with Paramount Pictures.

Court’s Reasoning

The Tax Court considered various factors to determine Rose’s residency status, applying the same criteria used to determine whether an alien is a resident of the United States. The court noted that Rose’s employment in England was permanent and continuous, requiring his residence there. He took his family, personal effects, and furniture to England, leased an apartment, and integrated himself into English society. The court acknowledged Rose’s trips to the U.S., but stated that “vacation or business trips to the United States during the taxable year will not necessarily deprive a taxpayer, otherwise qualified, of the exemption provided by this section.” The court emphasized that Rose’s income was earned from services rendered in Great Britain, and the war necessitated his family’s temporary relocation to the U.S. The fact that Rose didn’t pay UK income taxes was not determinative because the exemption under Section 116(a) is not contingent upon payment of taxes to a foreign government.

Practical Implications

This case illustrates the factors considered when determining whether a U.S. citizen working abroad qualifies for the foreign-earned income exclusion under Section 116(a) (now Section 911). It confirms that temporary returns to the U.S. for vacation or business do not automatically disqualify a taxpayer from claiming bona fide residency in a foreign country. The key is the taxpayer’s intent and the nature of their connections to the foreign country. This case is frequently cited in disputes regarding foreign residency, emphasizing the importance of establishing a clear intent to reside in the foreign country and integrating into its society. Taxpayers should document their ties to the foreign country to support their claim of bona fide residency.

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