26 T.C. 528 (1956)

To qualify for the foreign earned income exclusion, a U.S. citizen must demonstrate bona fide residency in a foreign country, and the intent to return to a foreign country must be more than a “mere floating intention.”

Summary

The case involves Robert Henningsen, a U.S. citizen, who worked in China for many years. The primary issue was whether Henningsen qualified for the foreign earned income exclusion under Section 116(a) of the Internal Revenue Code of 1939. The court examined Henningsen’s residency, determining if he was a bona fide resident of China during 1946 and 1947, or at least for two years before returning to the U.S. The court found that while Henningsen had established bona fide residency in China before 1941, his return to the U.S. and subsequent actions demonstrated an abandonment of that residency, and he did not reestablish foreign residency to meet the requirements for the exclusion. Furthermore, the court also addressed the timing of a bonus payment and upheld the assessment of a penalty for failure to file a tax return.

Facts

Robert Henningsen, a U.S. citizen, worked for the Henningsen Produce Company in Shanghai, China, from 1929 to 1941. His wife and children left China in 1940 due to the war, and Henningsen returned to the U.S. in November 1941. He remained in the U.S. until February 1946, when he returned to Shanghai. He subsequently returned to the United States in December 1947. He purchased residence property in Portland, Oregon, in July 1945. In 1946 and 1947, he received significant income from the Produce Company. He did not file a tax return for 1946. He was paid a bonus in 1947, although the company deducted it on its 1946 return. In late 1947, Henningsen and his brother acquired the franchise to bottle and distribute Coca-Cola in Hong Kong.

Procedural History

The Commissioner determined deficiencies in Henningsen’s income tax for 1946 and 1947 and imposed an addition to tax for failure to file a return in 1946. The case was heard by the U.S. Tax Court on stipulated facts and additional evidence. The Commissioner was granted leave to amend his answer to claim an increased deficiency for 1947 if the bonus was deemed taxable in that year. The Tax Court ruled on the issues, resulting in decisions entered under Rule 50.

Issue(s)

1. Whether Robert A. Henningsen was a bona fide resident of China during the years 1946 and 1947.

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2. If not for the entire year 1947, whether Henningsen had been a bona fide resident of China "for a period of at least two years before the date on which he * * * [changed] his residence from such country to the United States," within the scope and intendment of Section 116 (a) (2) of the Internal Revenue Code of 1939.

3. Whether the Commissioner properly imposed an addition to tax for 1946 for the failure of Robert A. Henningsen to file a return for that year.

4. Whether a $100,000 bonus paid to Henningsen was taxable in 1946 or 1947.

Holding

1. No, because the court found that Henningsen had abandoned his bona fide China residence upon his return to the United States in 1941, and he did not reestablish residency during the relevant tax years.

2. No, because the court found that Henningsen had not been a bona fide resident of China for two years before changing his residence to the United States, and he did not establish residency in Hong Kong.

3. Yes, because the court found Henningsen's failure to file a tax return was not due to reasonable cause.

4. The court held that the bonus was properly taxable in 1947.

Court's Reasoning

The court differentiated between residence and domicile. It emphasized that, for tax purposes, residence depends on the taxpayer's intentions regarding the length and nature of their stay, not simply their domicile. The court referenced regulations stating, "An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay." The court determined that when Henningsen returned to the United States in 1941, his intent was to remain, and he did not reestablish a bona fide residence in China until February 1946. It found his actions demonstrated a shift in residency due to the war, and any intention to return to China was not a "definite intention" but a "mere floating intention, indefinite as to time." The court also rejected Henningsen's claim that he was a resident of Hong Kong, as he never established a physical residence there. Regarding the penalty for failure to file, the court found that Henningsen's belief he did not need to file was not based on advice from a professional. The court concluded that the bonus was taxable in 1947, not 1946, as it was not unqualifiedly available to Henningsen until January 1947.

Practical Implications

This case highlights the importance of establishing a clear and consistent intent to

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maintain residency in a foreign country to qualify for the foreign earned income exclusion. It underscores that a mere intention to return is insufficient, especially if that intent is indefinite or contingent on future events. Taxpayers relying on this exclusion must be prepared to demonstrate a “definite intention” of foreign residence to the IRS. This case would be cited by the IRS to deny the exclusion when the taxpayer has strong ties to the United States, or does not spend enough time in the foreign country.

Practitioners should advise clients to keep detailed records of their movements, activities, and intentions. A taxpayer’s actions and intent should show an active commitment to foreign residency beyond a temporary stay or a mere hope of returning. Furthermore, seeking professional tax advice and relying on that advice can provide a defense against penalties for non-filing.

In this case, the bonus payment timing is relevant for taxpayers who may be considered to have constructive receipt of income. It reinforces that income is taxable when it is unqualifiedly available to the taxpayer.

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