30 T.C. 26 (1958)

A nonresident alien's activities related to U.S. real property, such as receiving rental income and paying associated expenses, do not constitute engaging in a "trade or business" within the meaning of the U.S.-U.K. tax convention, unless those activities are considerable, continuous, and regular.

Summary

Elizabeth Herbert, a British subject, owned a rental property in Washington, D.C. and received dividends from a U.S. corporation. The IRS determined she was engaged in a U.S. "trade or business" through her rental activities and therefore not eligible for reduced U.S. tax rates on dividends and rentals under the U.S.-U.K. tax convention. The Tax Court held that Herbert's activities, which consisted primarily of receiving rental income and paying related expenses, were not sufficiently active, continuous, or regular to constitute a "trade or business" under the convention. The court focused on the limited nature of her involvement in the property's management, which was largely handled by a tenant under a long-term lease. The ruling clarified the standards for determining when a nonresident alien's real estate investments trigger U.S. tax obligations.

Facts

Elizabeth Herbert, a British subject residing in England, owned a building in Washington, D.C., which she leased to a single tenant. During 1952 and 1953, her activities concerning the property, beyond receiving rent, included paying taxes, mortgage principal and interest, and insurance. She also received dividends from a U.S. corporation. The lease agreement delegated most operational and repair responsibilities to the tenant. The tenant was responsible for all repairs except for the foundation and outer walls. Herbert's activities were passive and not a primary focus for her. Herbert had appointed her sister with a power of attorney who managed the property. Herbert also visited the United States for approximately two months in each of the years 1952 and 1953.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Herbert's federal income taxes for 1952 and 1953, arguing she was engaged in a U.S. trade or business and therefore not eligible for reduced tax rates under the U.S.-U.K. tax convention. Herbert contested this, leading to a case in the United States Tax Court.

Issue(s)

1. Whether Herbert, a British subject, was engaged in a "trade or business" in the United States during 1952 and 1953, under the U.S.-U.K. income tax convention, by reason of her activities in connection with the rental property.

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Holding

1. No, because the court found that Herbert's activities were not sufficiently active, continuous, and regular to constitute a "trade or business."

Court's Reasoning

The court examined Article IX of the U.S.-U.K. tax convention, which limits U.S. tax rates on rentals received by U.K. residents not engaged in a U.S. trade or business. The court recognized that merely owning and leasing real property does not automatically constitute a trade or business. Relying on the holding in *Evelyn M. L. Neill, 46 B.T.A. 197*, the court found that Herberts activities did not go beyond the scope of mere ownership of the real property and were not sufficiently considerable, continuous, and regular as required by prior case law like *Jan Casimir Lewenhaupt, 20 T. C. 151*. The court emphasized that the tenant had complete operational control of the property, with Herbert's involvement limited to passive receipt of income and payment of certain expenses. The court differentiated her situation from cases where nonresident aliens actively managed multiple properties, engaged in property development, or otherwise demonstrated substantial business activity.

Practical Implications

This case provides guidance for determining whether a nonresident alien's real estate activities trigger U.S. tax obligations under tax treaties. It highlights the importance of the nature and extent of the activities. The court's ruling emphasizes that the level of activity must be more than mere ownership and passive receipt of income for a trade or business to exist. Lawyers advising nonresident aliens with U.S. real estate investments must carefully analyze the client's activities, including property management, repairs, and other dealings, to assess the potential for a U.S. trade or business and the impact on their tax liability. The case also reinforces the impact of tax treaties in modifying general tax rules for international investments and income.

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