T.C. Memo. 1957-66

To qualify for the foreign earned income exclusion under Section 116(a)(1) of the 1939 Internal Revenue Code, a U.S. citizen must be a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year; temporary stays or stopovers do not constitute bona fide residence.

Summary

Donald H. Nelson, a retired U.S. military officer, was employed for a telecommunications project in Ethiopia. He and his wife traveled from the U.S., intending to go directly to Ethiopia, but stopped in France to handle preliminary matters. Unexpected delays extended their stay in France for several months. The Tax Court considered whether the Nelsons were bona fide residents of a foreign country for an entire taxable year to qualify for the foreign earned income exclusion. The court held that while they were bona fide residents of Ethiopia, their time in France was merely a temporary stopover and did not qualify as foreign residence. Consequently, they did not meet the requirement of bona fide residence in a foreign country for an entire taxable year.

Facts

Petitioners, Donald H. Nelson and his wife Edwina C. Nelson, were U.S. citizens. Donald Nelson, after retiring from the military in 1949, was hired for a telecommunications project in Ethiopia in 1951. Prior to departing the U.S., they obtained passports listing foreign addresses in Ethiopia. They sold their belongings and leased their ranch in Oregon. They departed the U.S. on November 21, 1951, en route to Ethiopia, but first stopped in Paris, France, for project-related matters. Unexpected delays caused them to remain in France from November 28, 1951, to February 28, 1952. During this time, they resided in a hotel in Paris and traveled to other European countries. They arrived in Addis Ababa, Ethiopia, on March 2, 1952, and stayed until March 13, 1953. Nelson received his salary from the Ethiopian government for his work on the telecommunications project.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Nelsons' income tax for 1952 and 1953. The Nelsons petitioned the Tax Court, contesting this determination.

Issue(s)

1. Whether the petitioners were bona fide residents of a foreign country or countries for an uninterrupted period which includes an entire taxable year, as required by section 116(a)(1) of the Internal Revenue Code of 1939, to exclude foreign earned income from their gross income.

Holding

1. No. The Tax Court held that the petitioners were not bona fide residents of a foreign country or countries for a period including an entire taxable year.

Court's Reasoning

The court emphasized that determining bona fide residence is a factual question decided on a case-by-case basis. While acknowledging the Nelsons were bona fide residents of Ethiopia from March 2, 1952, to March 13, 1953, this period did not encompass an entire taxable year (calendar year 1952). The court then considered whether their stay in France could be considered bona fide foreign residence. The court reasoned that the Nelsons went to France solely for matters related to their Ethiopian project and initially intended a brief stay. Despite unforeseen delays prolonging their time in France, the court concluded their stay was a "mere stopover, a delay in their movement from the United States to their destination of Addis Ababa." They were deemed "transients or sojourners in France, and not bona fide residents." The court cited Treasury Regulations defining a non-resident alien as one who is "merely a transient or sojourner." The court stated, "They were in France 'for a definite purpose which in its nature may be promptly accomplished.' See Regs. 118, sec. 39.211-2". Because the Nelsons' time in France was not considered bona fide foreign residence, and their Ethiopian residence did not cover a full taxable year, they failed to meet the statutory requirements for the foreign earned income exclusion. The burden of proof was on the petitioners to demonstrate they qualified for the exemption, which they failed to do.

Practical Implications

Nelson v. Commissioner clarifies that physical presence in a foreign country is not automatically equivalent to bona fide residence for tax purposes. The case underscores the importance of intent and the nature of the stay. Taxpayers intending to claim the foreign earned income exclusion must demonstrate more than just being physically present in a foreign country; they must establish bona fide residence, indicating a degree of permanence and integration into the foreign environment. Temporary stays, even if unexpectedly prolonged, particularly those considered preparatory or transitional to reaching a final foreign destination, may not qualify as bona fide foreign residence. This case highlights that the IRS and courts will scrutinize the circumstances of a taxpayer's foreign stay to determine if it meets the criteria for bona fide residence, focusing on whether the stay is more than a transient or temporary visit.

