33 T.C. 1097 (1960)

A U.S. citizen working abroad for an agency of the United States, even if not directly paid with appropriated funds, is not entitled to exclude their income from U.S. taxation under the provisions of Section 116(a) of the 1939 Internal Revenue Code.

Summary

Frank E. Raffensperger, a U.S. citizen residing in Japan, sought to exclude his salary as manager of the Union Club of Tokyo from his 1953 taxable income, claiming it was earned abroad and not paid by a U.S. agency, thus falling under the provisions of section 116(a) of the Internal Revenue Code of 1939. The Internal Revenue Service (IRS) determined a deficiency, arguing the club was a U.S. agency. The Tax Court sided with the IRS, holding the Union Club of Tokyo was a nonappropriated fund activity and therefore an agency of the United States. As a result, Raffensperger was not allowed to exclude his salary from his gross income for U.S. tax purposes.

Facts

Frank E. Raffensperger managed the Union Club of Tokyo from 1949 to 1956 and was a U.S. citizen residing in Japan. In 1953, the club paid Raffensperger a salary. The Union Club of Tokyo originated as the American Club in 1946 following a directive from the Assistant Chief of Staff, U.S. Army Forces, Pacific. The club's constitution and bylaws were approved by the Army, and it operated under Army regulations as a nonappropriated fund activity. The club was responsible for its own funds, and it provided recreational facilities. Although the Army provided some support like utilities, the club's operations were largely self-funded. Raffensperger had a contract with the club and was paid by the club itself. The IRS determined that Raffensperger's salary from the club was taxable income because the club was a U.S. agency, and Raffensperger contested this ruling.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Raffensperger's income tax for 1953. Raffensperger filed a petition with the United States Tax Court, contesting the IRS's determination that his salary was taxable. The Tax Court considered the issue of whether the Union Club of Tokyo was an agency of the United States. The court ultimately ruled in favor of the Commissioner, leading to a decision of deficiency entered against the taxpayer.

Issue(s)

1. Whether a proper notice of deficiency was mailed to petitioners prior to the expiration of the statute of limitations.

2. Whether the salary paid to Frank E. Raffensperger by the Union Club of Tokyo in

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1953 was paid by an agency of the United States and thus not excludible from his gross income under Section 116(a) of the 1939 Internal Revenue Code.

Holding

1. No, this issue was conceded by petitioners.

2. Yes, because the Union Club of Tokyo was found to be a nonappropriated fund activity of the Army, and therefore an agency of the United States. Therefore, the salary paid by the Club was not excludable.

Court's Reasoning

The court relied heavily on the interpretation and application of Army Regulations 210-50 and 210-100, which govern nonappropriated fund activities. These regulations, according to the court, have the force and effect of law. The court reviewed the regulations and concluded that the Union Club of Tokyo was organized and operated as a nonappropriated sundry fund activity under the Army regulations, even after the peace treaty with Japan. Key factors in the court's determination included the club's original establishment under Army directives, the approval required for its constitution and bylaws, the financial structure of the club (operating with nonappropriated funds), and the Army's continued supervision and control over its operations, including approval of policy decisions and management remuneration. The court noted that the club's operation was consistent with that of a government instrumentality, and the absence of explicit military facility designation in the administrative agreement with Japan did not affect the club's status as a nonappropriated fund activity. The court also emphasized the importance of the parenthetical exception in section 116(a) to avoid double taxation or the exclusion of income earned by citizens outside the United States as employees of the United States or its agencies.

Practical Implications

This case clarifies the definition of a U.S. "agency" in the context of income earned abroad and its implications for tax exclusions. Taxpayers working for organizations with close ties to the U.S. government, even if not directly funded by appropriated funds, should anticipate that their income may be subject to U.S. taxation. Specifically, the decision serves as a warning that merely operating a club or a similar organization with some degree of autonomy and separate financial administration does not automatically shield income earned abroad from U.S. taxation when that organization is under the oversight of the U.S. military or the U.S. government. It is also relevant to understanding how governmental agencies are interpreted and established for tax purposes. Later cases, particularly in the context of expatriate taxation, would likely cite this case when determining if an organization qualifies as a U.S. agency. Lawyers advising taxpayers earning income from sources outside of the U.S. must consider not only the nature of the income but

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also the status and relationship of the payer of the income to the U.S. government.

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