Dillin v. Commissioner, 56 T. C. 228 (1971)

Nonresident aliens are taxed on income from U. S. sources, and community property rights can affect the taxation of income between spouses.

Summary

William Dillin, a U. S. citizen who renounced his citizenship and moved to the Bahamas, received payments from a drilling contract in Argentina. The court held that as a nonresident alien using the cash method of accounting, Dillin was taxable on these U. S. -source income payments. The court also determined that under Texas community property law, his wife Patrea, who remained a U. S. citizen, had a vested interest in half of the income, making her taxable on that portion. The complexity of the case led the court to waive penalties for underpayment and failure to file.

Facts

William N. Dillin and his wife Patrea L. Dillin were U. S. citizens residing in Texas when William performed services in 1958 that led to a drilling contract in Argentina. In July 1958, William agreed with Southeastern Drilling Corp. to receive a percentage of the net profits from any resulting contract. The contract was awarded in 1959, and William received payments in 1963, 1964, and 1965 after he had renounced his U. S. citizenship and moved to the Bahamas. Patrea accompanied him but retained her U. S. citizenship.

Procedural History

The Commissioner of Internal Revenue issued notices of jeopardy assessments for deficiencies and additions to tax for the years 1963, 1964, and 1965. The Dillins filed petitions with the U. S. Tax Court, which consolidated the cases for trial, briefs, and opinion.

Issue(s)

1. Whether William Dillin was taxable on the payments because he was a U. S. citizen at the time he engaged in the activity which gave rise to the payments.
2. If not, whether William Dillin was a nonresident alien at the time he received the payments.
3. If William Dillin was a nonresident alien, whether the payments were from sources within the United States.
4. Whether Patrea Dillin was taxable upon one-half of the payments by virtue of Texas community property law.
5. Whether the Commissioner erred in determining certain additions to the tax of both petitioners.

Holding

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1. No, because as a cash basis taxpayer, William Dillin was taxable on income received after he became a nonresident alien.
2. Yes, because William Dillin effectively abandoned his U. S. residence and established residency in the Bahamas.
3. Yes, because the payments were compensation for services performed in the United States.
4. Yes, because under Texas community property law, Patrea Dillin had a vested interest in one-half of the income.
5. Yes, because the complexity of the issues provided reasonable cause for not filing returns and the underpayments were not due to negligence.

Court’s Reasoning

The court applied section 872(a) of the Internal Revenue Code, which states that nonresident aliens are taxed only on U. S. -source income. William Dillin was considered a nonresident alien at the time of receipt because he had renounced his citizenship and moved to the Bahamas. The court determined that the payments were for services performed in the United States, as William’s role was primarily to introduce the opportunity to Southeastern Drilling Corp. The court also applied Texas community property law, finding that Patrea had a vested interest in half the income at the time it was earned. The complexity of the case and the reasonable belief that the income was exempt led the court to waive penalties under sections 6651(a) and 6653(a).

Practical Implications

This decision clarifies that nonresident aliens using the cash method of accounting are taxed on income from U. S. sources, regardless of when the income was earned. It also highlights the importance of community property laws in determining the taxation of income between spouses. Legal practitioners should consider the timing of income receipt and the impact of state property laws when advising clients on tax planning, especially in cases involving expatriation. This case has been cited in subsequent decisions involving the taxation of nonresident aliens and the application of community property laws.

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