Kalinski v. Commissioner, 64 T. C. 127 (1975)

An entity is considered an agency of the United States if it is under pervasive government control, effectuates government purposes, operates on a nonprofit basis, and is limited to government-connected persons.

Summary

In Kalinski v. Commissioner, the Tax Court determined that the USAFE Child Guidance Center in Germany was an agency of the United States, making the income earned by its employees taxable under Section 911(a)(2) of the Internal Revenue Code. The petitioners, employed at the Center, sought to exclude their foreign earnings from their taxable income. However, the court found that the Center was established and operated under significant Air Force control and influence, fulfilling Air Force objectives without private profit, and thus did not qualify for the tax exclusion.

Facts

In 1969, Dorothy M. Kalinski and Carol Marie Schmidt worked at the USAFE Child Guidance Center in Wiesbaden, Germany, earning $5,890. 59 and $8,892. 98, respectively. The Center, established to treat handicapped children of Air Force personnel in Europe, was under the supervision of an Air Force psychiatrist and operated under the Air Force's "Children Have A Potential" (CHAP) program. Its funding came from the Air Force Aid Society (AFAS), parental fees, and the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). The petitioners excluded their earnings from their 1969 federal income tax returns, claiming eligibility under Section 911(a)(2), which excludes income earned abroad except for amounts paid by the U. S. or its agencies.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' 1969 federal income taxes. The Tax Court consolidated the cases for trial, focusing on whether the Center qualified as an agency of the United States under Section 911(a)(2). The court's ultimate finding was that the Center was such an agency, leading to the conclusion that the petitioners' income was taxable.

Issue(s)

1. Whether the USAFE Child Guidance Center was an agency of the United States under Section 911(a)(2) of the Internal Revenue Code.

Holding

1. Yes, because the Center was established and operated under pervasive Air Force control, solely to effectuate Air Force purposes, on a nonprofit basis, and limited to

Air Force-connected persons.

Court’s Reasoning

The court applied the criteria for determining an agency of the United States as established in prior cases like Morse v. United States and Cecil A. Donaldson. The Center’s operation was subject to Air Force control, with its establishment directly linked to Air Force needs, and its funding and operations were closely tied to military channels. The court emphasized the lack of private profit motive and the exclusivity of services to Air Force personnel. The court rejected the petitioners’ argument that the Center was merely a conduit for funds from AFAS and other sources, noting that the Center itself was the true payor of salaries. The court also dismissed the relevance of whether the Center was a nonappropriated fund activity, focusing instead on the broader criteria for agency status under Section 911(a)(2).

Practical Implications

This decision clarifies the criteria for determining whether an entity is an agency of the United States for tax purposes, particularly in the context of foreign income exclusion under Section 911(a)(2). Legal practitioners must consider the degree of government control, the purpose and operation of the entity, and its nonprofit status when advising clients on tax exclusions for foreign earnings. The ruling may affect how similar organizations, especially those affiliated with military or government programs, structure their operations and funding to potentially qualify for tax exemptions. Subsequent cases have referenced Kalinski to distinguish or apply its principles, influencing the analysis of tax status for entities operating abroad.

