McComish v. Commissioner, 64 T. C. 909 (1975)

The government of the Trust Territory of the Pacific Islands is considered an 'agency' of the United States for the purpose of excluding foreign earned income under Section 911(a)(2) of the Internal Revenue Code.

Summary

John D. McComish, a U. S. citizen employed as a district attorney by the government of the Trust Territory of the Pacific Islands, sought to exclude his salary from U. S. income tax under Section 911(a)(2) of the Internal Revenue Code, which exempts foreign-earned income. The issue was whether the Trust Territory's government qualified as a U. S. 'agency,' making the income non-exempt. The U. S. Tax Court held that the Trust Territory government was an agency of the U. S. due to its creation and control by the U. S. government, thereby disallowing McComish's exclusion of his salary from gross income. This decision underscores the broad interpretation of 'agency' in tax law and its implications for U. S. citizens working for entities under significant U. S. control abroad.

Facts

John D. McComish, a U. S. citizen, was employed as a district attorney by the government of the Trust Territory of the Pacific Islands (Trust Territory) from April 14, 1967, to April 14, 1969. He lived on Saipan and received $15,144 in 1968 from the Trust Territory. The Trust Territory, established under a U. N. trusteeship agreement with the U. S. as the administering authority, had a government structure similar to the U. S. federal system but was under the control of the U. S. Secretary of the Interior. McComish excluded this income from his 1968 U. S. tax return under Section 911(a)(2), which allows U. S. citizens to exclude income earned in foreign countries under certain conditions, except for amounts paid by the U. S. or any agency thereof. The Commissioner of Internal Revenue challenged this exclusion, asserting that the Trust Territory government was a U. S. agency.

Procedural History

The Commissioner determined a deficiency in McComish's 1968 federal income tax and McComish petitioned the U. S. Tax Court for review. The Tax Court was tasked with deciding whether the Trust Territory government was an 'agency' of the U. S. under Section 911(a)(2), thus affecting the taxability of McComish's income.

Issue(s)

1. Whether the government of the Trust Territory of the Pacific Islands is considered an 'agency' of the United States within the meaning of Section 911(a)(2) of the Internal Revenue Code.

Holding

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1. Yes, because the government of the Trust Territory was established by the U. S. , was subject to the control of the U. S. Secretary of the Interior, and served as an instrumentality of U. S. policy, making it an ‘agency’ of the U. S. under Section 911(a)(2).

Court’s Reasoning

The court’s reasoning centered on the definition of ‘agency’ under Section 911(a)(2). The court determined that ‘agency’ encompassed a broader range of entities than formal U. S. government departments, including instrumentalities that serve U. S. governmental purposes and are subject to U. S. control. The Trust Territory government was established by the U. S. under a trusteeship agreement, and its executive, legislative, and judicial powers were controlled by the U. S. Secretary of the Interior. The court cited prior cases that recognized various foreign entities as U. S. agencies for tax purposes due to U. S. control. The court rejected McComish’s argument that the Trust Territory’s use of locally generated revenue should affect its agency status, emphasizing that the source of funds did not alter the government’s status as a U. S. instrumentality. The court also dismissed McComish’s legislative purpose argument, stating that the broad language of the statute reflected Congressional intent to apply the exception broadly.

Practical Implications

This decision has significant implications for U. S. citizens working abroad for entities under U. S. control. It broadens the definition of ‘agency’ for tax purposes, potentially affecting the tax treatment of income earned by U. S. citizens in territories or countries where the U. S. exerts significant control over local government. Legal practitioners must consider this ruling when advising clients on the tax implications of working for such entities, as income may not be eligible for exclusion under Section 911(a)(2). The decision also highlights the need to examine the specific context and legislative purpose of the term ‘agency’ in various federal statutes, as its meaning can vary. Subsequent cases, such as Groves v. United States, have followed this interpretation, reinforcing the principle that foreign governments under U. S. control can be considered U. S. agencies for tax purposes.

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