Rosenkranz v. Commissioner, 65 T. C. 993 (1976); 1976 U. S. Tax Ct. LEXIS 157

A nonresident alien spouse's community property share of income earned in the U. S. by their spouse is taxable under section 871(c) of the Internal Revenue Code.

Summary

In Rosenkranz v. Commissioner, the U. S. Tax Court held that both salary and capital gains earned by George Rosenkranz, a nonresident alien, in the U. S. were community property under Mexican law. The court also ruled that Edith Rosenkranz, George's wife, was taxable on her half of this income under section 871(c) of the Internal Revenue Code. This decision was significant because it clarified that a nonresident alien spouse's share of community property income derived from U. S. sources is subject to U. S. taxation, even if the spouse did not personally engage in business activities in the U. S.

Facts

George W. Rosenkranz and Edith Rosenkranz, both nonresident aliens, were married in Cuba in 1945 and moved to Mexico City later that year. They became Mexican citizens in 1949. From 1958 through 1967, George earned over $3,000 annually from U. S. sources through his employment with Syntex Corp. and realized capital gains from stock sales in New York during 1958-1962. Edith did not engage in any business activities in the U. S. during these years. They reported their U. S. source income as community property on their tax returns, with Edith reporting half of George's salary but none of the capital gains.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Rosenkranzes' federal income taxes, asserting that all of George's U. S. source income was taxable to him, and alternatively, that Edith should be taxed on her half if the income was community property. The Tax Court heard the case, and after considering the applicable Mexican and Cuban laws, as well as expert testimony, rendered its decision.

Issue(s)

1. Whether the income of petitioners from sources within the United States was community property under the governing law of Mexico.
2. Assuming an affirmative answer to issue 1, whether the community share of petitioner Edith Rosenkranz in such income was subject to Federal income taxes under section 871 of the Internal Revenue Code.

Holding

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1. Yes, because under Mexican law, which looked to Cuban law due to the Rosenkranzes' circumstances at the time of their marriage, the income was deemed community property.
2. Yes, because Edith's community share of both the salary and capital gains was taxable under section 871(c), as George's activities in the U. S. were considered to be on behalf of the community.

Court's Reasoning

The court applied Mexican law, which directed it to Cuban law due to the Rosenkranzes' domicile in Cuba at the time of marriage and their stateless status. Cuban law, specifically Article 1315 of the Civil Code, established that in the absence of a contract, their marriage was under a community property regime. The court also interpreted Cuban law to mean that Edith had a vested interest in half of George's earnings and capital gains. For the second issue, the court relied on the community property doctrine, reasoning that George's U. S. business activities were conducted on behalf of the community, making Edith's share taxable under section 871(c). The court rejected Edith's argument that section 871(a)(2)(A) exempted her from taxation on capital gains because she was not present in the U. S. during the relevant years, holding that the community property nature of the income made section 871(c) applicable.

Practical Implications

This decision impacts how nonresident aliens married under a community property regime should report and pay taxes on U. S. source income. It underscores the importance of understanding the applicable foreign marital property laws when determining U. S. tax liability. Legal practitioners advising nonresident aliens must consider the community property status of their clients' income, even if the non-earning spouse has no direct U. S. business activities. This case has been followed in subsequent rulings, such as Alejandro Zaffaroni, reinforcing the principle that a nonresident alien spouse's community property share is taxable under U. S. law. It also has broader implications for international tax planning, affecting how multinational couples structure their financial affairs to manage their tax obligations.

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