Alejandro Zaffaroni, Petitioner v. Commissioner of Internal Revenue, Respondent; Lyda Zaffaroni, Petitioner v. Commissioner of Internal Revenue, Respondent, 65 T. C. 982 (1976)

Community income earned by a nonresident alien from U. S. sources is taxable to both spouses under U. S. tax law, regardless of their physical presence in the U. S.

Summary

Alejandro and Lyda Zaffaroni, Uruguayan citizens domiciled in Mexico, were taxed on their U. S. -sourced income. Alejandro earned a salary and capital gains from stock transactions in the U. S. The Tax Court held that this income was community property under Mexican and Uruguayan law, and thus, both spouses' shares were taxable under Section 871(c) of the Internal Revenue Code, which taxes nonresident aliens engaged in U. S. business. The court rejected Lyda's argument that her share of capital gains was exempt due to her absence from the U. S. , emphasizing that Alejandro's actions as the community's agent made both spouses' shares taxable.

Facts

Alejandro and Lyda Zaffaroni, married in Uruguay in 1946, were domiciled in Mexico from 1951 to 1962. During 1958-1961, Alejandro earned over $3,000 annually from U. S. sources through his employment with Syntex Corp. He also realized capital gains from stock sales executed through New York brokers. Both spouses filed U. S. tax returns as nonresident aliens, with Alejandro reporting his community share of salary and capital gains, and Lyda reporting her community share of salary but not capital gains.

Procedural History

The Commissioner determined deficiencies in the Zaffaronis' federal income taxes for the years 1958-1961, asserting that all income should be taxed to Alejandro or, alternatively, that Lyda's community share should be taxed under Section 871(c). The Zaffaronis petitioned the U. S. Tax Court, which ruled that the income was community property and taxable to both spouses under Section 871(c).

Issue(s)

1. Whether the Zaffaronis' income from U. S. sources was community property under Mexican law.
2. Whether Lyda's community share of the income was taxable under Section 871(a) or Section 871(c).

Holding

1. Yes, because the Zaffaronis were domiciled in Mexico, and Mexican law, which applied Uruguayan law, treated the income as community property.

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2. Yes, because Lyda's community share was taxable under Section 871(c) as U. S. business income, despite her absence from the U. S. , since Alejandro earned the income as the community's agent.

Court's Reasoning

The court applied the conflict of laws principle that the law of the domicile governs movable property, determining that Mexican law applied. Mexican law, in turn, looked to Uruguayan law, which treated the income as community property. The court then analyzed Section 871, concluding that Alejandro's engagement in U. S. business made the community income taxable to both spouses under Section 871(c). The court rejected Lyda's argument that her absence from the U. S. exempted her share of capital gains from tax, citing cases like *Poe v. Seaborn* that established the community nature of such income. The court also noted that allowing Lyda's share to escape tax would frustrate the purposes of Section 871.

Practical Implications

This decision clarifies that nonresident alien spouses' community income from U. S. sources is taxable to both spouses under U. S. tax law, even if one spouse is not physically present in the U. S. It underscores the importance of considering the community property laws of the spouses' domicile when determining tax liability. Practitioners advising nonresident alien clients should be aware that the actions of one spouse as the community's agent can create tax liability for both under Section 871(c). This ruling may impact how international couples structure their financial affairs to manage U. S. tax exposure and has been applied in subsequent cases involving similar issues.

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