Vitale v. Commissioner, 72 T. C. 386 (1979)

A nonresident alien who becomes a partner in a U. S. partnership is taxable on all U. S. source income realized during the taxable year, including gains from transactions before the partnership commenced business.

Summary

Alberto Vitale, an Italian national and nonresident alien, realized capital gains from the liquidation of Export-Import Woolens, Inc. , and the subsequent sale of stock received. He later became a limited partner in a U. S. partnership formed from the same business. The court held that Vitale was taxable on these gains under Section 871(c) because his partnership status made him engaged in trade or business in the U. S. for the entire taxable year, as per Section 875 and its regulations. This decision emphasized that a nonresident alien's tax liability is determined by partnership status at any time during the year, impacting how similar cases should be analyzed regarding the timing of income realization and partnership involvement.

Facts

Alberto Vitale, an Italian national residing in Switzerland, owned 18. 6% of Export-Import Woolens, Inc. , a U. S. corporation. On or before May 2, 1966, the corporation was liquidated, and Vitale received stock and other assets, realizing a long-term capital gain. On the same day, he became a limited partner in Export-Import Woolens Co. , a New York limited partnership succeeding the corporation's business. On or before May 6, 1966, Vitale sold part of the stock received from the liquidation, realizing a short-term capital gain. He was not in the U. S. for more than 90 days in 1966 and filed a nonresident alien income tax return, reporting only partnership income.

Procedural History

The Commissioner determined a deficiency in Vitale's 1966 federal income tax, asserting that he was taxable on the capital gains from the liquidation and stock sale under Section 871(c). Vitale petitioned the U. S. Tax Court, which initially considered the case under Rule 122(a) based on stipulated facts. The court later reopened the record to allow evidence on when the partnership commenced business in the U. S.

Issue(s)

1. Whether a nonresident alien who becomes a limited partner in a U. S. partnership is taxable on capital gains realized from U. S. sources during the taxable year but before the partnership commenced business in the U. S.

Holding

1. Yes, because under Section 875 and its regulations, a nonresident alien is considered engaged in trade or business in the U. S. if their partnership is so engaged at any time during the taxable year, making all U. S. source income taxable under Section 871(c).

Court's Reasoning

The court's decision hinged on the interpretation of Sections 871(c) and 875, along with the applicable regulations. Section 875 states that a nonresident alien is engaged in trade or business in the U. S. if the partnership of which they are a member is so engaged. The regulation under Section 1. 875-1 specifies that this status applies if the partnership is engaged in business at any time during the taxable year. The court rejected Vitale's argument that only gains realized after becoming a partner should be taxable, noting that the regulation's long-standing interpretation and congressional reenactment without change supported its validity. The court cited *Craik v. United States* to affirm that a nonresident alien's tax status through partnership is equivalent to individual engagement in U. S. business. The court also considered that while this might disadvantage Vitale, it could benefit other taxpayers by allowing offset of pre-partnership losses against post-partnership gains.

Practical Implications

This decision impacts how nonresident aliens involved in U. S. partnerships are taxed, requiring them to consider all U. S. source income during the entire taxable year, not just the period after becoming a partner. Legal practitioners must advise clients on the timing of income realization and partnership involvement, as it affects tax liability. Businesses forming partnerships with nonresident aliens must be aware of the potential tax implications for their partners. Subsequent cases have applied this ruling, reinforcing the principle that partnership status at any point during the year triggers tax liability for the entire year's U. S. source income. This case underscores the importance of understanding the interplay between partnership law and tax regulations for nonresident aliens.

