Hammock v. Commissioner, 71 T. C. 414 (1978)

The U. S. can tax its citizens on worldwide income despite tax treaties, but relief from double taxation is provided by the treaty through foreign tax credits.

Summary

In Hammock v. Commissioner, the Tax Court ruled on the taxation of a U. S. citizen residing in France and employed by IBM-Europe. The key issue was whether the U. S. -France tax treaty prevented the U. S. from taxing the petitioner's income earned in the U. S. The court held that the U. S. could tax its citizens on worldwide income, including income earned in the U. S. , as per the Internal Revenue Code. The court clarified that the treaty's savings clause allowed this taxation but that relief from double taxation should be sought through a foreign tax credit from France, not the U. S. This decision underscores the priority of U. S. tax laws over treaty provisions for U. S. citizens and the procedural limits of seeking relief through treaty mechanisms.

Facts

The petitioner, a U. S. citizen and bona fide resident of France, was employed by IBM-Europe in 1972 and 1973. He spent five days each year in the U. S. on business, earning income allocated to U. S. sources. The IRS determined tax deficiencies for these years, recomputing the foreign tax credit. The petitioner contested this, arguing that the U. S. -France tax treaty's Article 25 (Mutual Agreement Procedure) and Article 15 (Dependent Personal Services) should prevent double taxation of his U. S. source income. The case was submitted based on stipulated facts.

Procedural History

The IRS issued a notice of deficiency to the petitioner for the years 1972 and 1973, which led to the filing of a petition with the U. S. Tax Court. The case was submitted to the court on a stipulation of facts, with the sole issue being the applicability of the U. S. -France tax treaty to the petitioner's situation.

Issue(s)

1. Whether Article 25 of the U. S. -France tax treaty provides the petitioner with a judicial remedy in the Tax Court against double taxation.
2. Whether the substantive provisions of the U. S. -France tax treaty prevent the U. S. from taxing the petitioner's U. S. source income.

Holding

1. No, because Article 25 establishes an administrative procedure, not a judicial remedy, which must be initiated with the competent authority of France, not in the U. S. Tax Court.

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2. No, because the savings clause in Article 22 of the treaty allows the U. S. to tax its citizens on worldwide income, overriding Article 15, and relief from double taxation must be sought through a French tax credit.

Court's Reasoning

The court reasoned that Article 25 of the treaty provides for an administrative, not judicial, process for resolving tax disputes, which must be initiated by the taxpayer with the competent authority of their resident country, in this case, France. Regarding the substantive provisions, the court applied the savings clause in Article 22(4)(a), which reserves the right of the U. S. to tax its citizens as if the treaty did not exist. This clause takes precedence over Article 15, which might otherwise exempt the petitioner's U. S. source income from U. S. taxation. The court also interpreted Article 23 to mean that relief from double taxation should come in the form of a foreign tax credit from France, not the U. S. , based on the treaty's language and the U. S. Internal Revenue Code's source of income rules. The court emphasized the policy of the U. S. to tax its citizens on worldwide income and noted that the treaty's provisions were intended to work in conjunction with, not override, U. S. tax laws.

Practical Implications

This decision clarifies that U. S. citizens cannot use tax treaties to avoid U. S. taxation on worldwide income, including income earned abroad. It reinforces the importance of the savings clause in U. S. tax treaties and directs U. S. citizens to seek relief from double taxation through foreign tax credits from the country of residence, not the U. S. Practically, attorneys should advise U. S. citizens working abroad to understand the interplay between U. S. tax laws and tax treaties and to engage in competent authority procedures if necessary. This case has been cited in later decisions to uphold the U. S. 's right to tax its citizens globally and has influenced the interpretation of similar clauses in other U. S. tax treaties.

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