McCain v. Commissioner, 81 T. C. 918 (1983)

U. S. citizens working abroad for U. S. agencies cannot exclude their income under Sections 911 and 913 of the Internal Revenue Code.

Summary

Charles McCain, a U. S. citizen working in the Panama Canal Zone for the U. S. government, sought to exclude his income under Sections 911 and 913 of the IRC, and claimed exemption from U. S. tax under the Panama Canal Treaty. The U. S. Tax Court held that McCain was not entitled to these exclusions because his income was from a U. S. agency, and the Treaty did not exempt him from U. S. taxation. This decision clarified the scope of tax exclusions for U. S. citizens working abroad and the impact of international treaties on domestic tax laws.

Facts

Charles McCain, a U. S. citizen, was employed as a machinist in the Panama Canal Zone. From January to September 1979, he worked for the Panama Canal Co. , and from October to December 1979, for the Panama Canal Commission, both U. S. agencies. McCain claimed deductions under IRC Section 913 for excess foreign living expenses and an exclusion under Section 911 for foreign earned income. He also argued that post-October 1, 1979, his income was exempt from U. S. taxation due to the Panama Canal Treaty.

Procedural History

McCain filed a petition with the U. S. Tax Court challenging a deficiency determination by the IRS. The IRS argued that McCain was not entitled to the claimed deductions and exclusions. The Tax Court, after considering the arguments and evidence, issued a decision in favor of the Commissioner, denying McCain’s claims.

Issue(s)

1. Whether McCain is entitled to a deduction for excess foreign living expenses under IRC Section 913.
2. Whether McCain is entitled to a foreign earned income exclusion under IRC Section 911.
3. Whether the Panama Canal Treaty exempts McCain’s income from U. S. taxation after October 1, 1979.

Holding

1. No, because McCain’s income was from a U. S. agency, which is excluded under Section 913(j)(1)(A).
2. No, because Section 911(a) excludes income paid by U. S. agencies.

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3. No, because the Panama Canal Treaty and its implementing agreement exempt income from Panamanian, not U. S. , taxation.

Court’s Reasoning

The court applied the plain language of Sections 911 and 913, which explicitly exclude income from U. S. agencies. McCain’s income from the Panama Canal Co. and Commission fell within this exclusion. The court also examined the legislative history of the Panama Canal Treaty, concluding that the agreement was intended to exempt U. S. citizens from Panamanian taxes, not U. S. taxes. The court cited testimony from the treaty’s negotiators and official interpretations that supported this view. The decision was consistent with prior cases like *Standard Oil Co. v. Johnson* and *Smith v. Commissioner*, which upheld the taxation of income from U. S. sources.

Practical Implications

This decision clarifies that U. S. citizens working for U. S. agencies abroad cannot claim tax exclusions under Sections 911 and 913. It also underscores that international treaties do not automatically exempt U. S. citizens from domestic tax obligations unless explicitly stated. Practitioners must carefully review the source of income and applicable treaties when advising clients on foreign earned income exclusions. This ruling has influenced subsequent cases and reinforced the principle of worldwide taxation of U. S. citizens’ income.

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