Crow v. Commissioner, 85 T. C. 376 (1985)

Tax treaties can override domestic tax laws, specifically when a saving clause does not explicitly reserve the right to tax former citizens under domestic expatriation tax rules.

Summary

Tedd N. Crow, after expatriating to Canada to avoid U. S. taxes, sold his U. S. corporation stock in exchange for a non-interest-bearing note. The U. S. sought to tax the capital gain and imputed interest under IRC Section 877, which targets expatriation to avoid taxes. The court held that the 1942 U. S. -Canada tax treaty exempted Crow's capital gain from U. S. taxation due to the treaty's lack of a specific saving clause for former citizens. However, the court upheld the U. S. 's right to tax imputed interest at a reduced treaty rate, as such income was not explicitly covered by the treaty's capital gains exemption.

Facts

Tedd N. Crow, a U. S. citizen, moved to Canada in November 1978 and renounced his U. S. citizenship shortly thereafter, primarily to avoid U. S. taxes. He owned all the stock of a U. S. corporation and sold it on December 1, 1978, in exchange for a $6,366,000 note payable over 20 years with no interest. Crow did not report any income from this transaction on his U. S. tax returns. The IRS asserted that Crow was taxable on the long-term capital gain from the stock sale and on the imputed interest income from the note under IRC Section 877 and Section 483, respectively.

Procedural History

Crow filed a motion for summary judgment in the U. S. Tax Court, arguing that the 1942 U. S. -Canada tax treaty exempted his income from U. S. taxation. The Commissioner opposed, citing IRC Section 877 and Revenue Ruling 79-152, which interpreted the treaty's saving clause to allow U. S. taxation of expatriates. The Tax Court granted Crow's motion regarding the capital gain but denied it regarding the imputed interest.

Issue(s)

1. Whether the 1942 U. S. -Canada tax treaty precludes the U. S. from taxing Crow's capital gain income under IRC Section 877.
2. Whether the income realized by Crow in connection with the transactions, including imputed interest, is exempt from U. S. taxation under the U. S. -Canada treaty.

Holding

1. Yes, because the treaty's saving clause does not explicitly reserve the right to tax

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former U. S. citizens under IRC Section 877, thereby overriding the domestic law.
2. No, because the treaty does not preclude the U. S. from taxing imputed interest income under IRC Section 483, as such income is not specifically exempted by the treaty.

Court's Reasoning

The court interpreted the 1942 U. S. -Canada treaty, focusing on the saving clause (Article XVII) and the capital gains provision (Article VIII). The court found that the saving clause's purpose was to preserve U. S. taxation of its citizens, not former citizens, based on the treaty's text, history, and contemporaneous interpretations. The court rejected the Commissioner's broad interpretation of "citizens" to include former citizens, as it conflicted with the treaty's clear language and the intent of the contracting parties. The court also noted that Congress, in enacting IRC Section 877, did not intend to override the treaty's provisions, as evidenced by the Foreign Investors Tax Act's treaty override provision (Section 110). Regarding imputed interest, the court ruled that the treaty's Article XI(1), which limits tax rates on certain income, applied to such income, even though it was not explicitly mentioned in the treaty's interest definition.

Practical Implications

This decision underscores the importance of specific language in tax treaties, particularly in saving clauses, when determining the tax treatment of expatriates. Practitioners should carefully analyze treaty provisions and their historical context when advising clients on the tax implications of expatriation. The ruling may encourage the U. S. to negotiate more explicit treaty language regarding the taxation of former citizens. For taxpayers, this case highlights the potential for tax treaties to provide relief from domestic tax laws, especially in the absence of clear treaty provisions allowing for such taxation. Subsequent cases, such as *Rust v. Commissioner*, have followed this reasoning, further solidifying the principle that treaties can override domestic laws absent specific treaty language to the contrary.

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