Amaral v. Commissioner, 90 T. C. 802 (1988)

Salaries paid directly by NATO to U. S. citizens are exempt from U. S. taxation under international agreements unless a specific secondment arrangement exists.

Summary

In Amaral v. Commissioner, the U. S. Tax Court ruled that Arthur Amaral's salary from NATO was exempt from U. S. taxation. Amaral, a U. S. citizen directly employed by NATO, was not hired under the London Agreement, which allowed the U. S. to tax its nationals seconded to NATO. The court interpreted Article 19 of the Ottawa Agreement to exempt direct hires' salaries from U. S. tax, emphasizing the importance of adhering to the clear language of international treaties and the intent of the signatories. This decision clarifies the tax treatment of U. S. nationals employed directly by NATO and underscores the necessity of specific agreements for taxation.

Facts

Arthur Amaral, a U. S. citizen, was employed by NATO from 1973 through the taxable years 1980 and 1981. He was directly hired by NATO and received his entire salary from NATO, not from the U. S. government. The Ottawa Agreement between NATO member states, effective from 1954, provided tax exemption for salaries paid by NATO to its international staff. The U. S. had entered into the London Agreement with NATO, which allowed the U. S. to hire and pay its nationals, then assign them to NATO, thereby retaining the right to tax these salaries. However, Amaral was not hired under this arrangement.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Amaral's federal income taxes for 1980 and 1981, asserting that his NATO salary was taxable. Amaral petitioned the U. S. Tax Court, which heard the case and ultimately ruled in favor of Amaral, holding that his salary was exempt from U. S. taxation.

Issue(s)

1. Whether the salary and emoluments paid to Arthur Amaral by NATO are exempt from U. S. taxation under Article 19 of the Ottawa Agreement.

Holding

1. Yes, because the clear language of Article 19 of the Ottawa Agreement exempts salaries paid directly by NATO to its employees from U. S. taxation, and Amaral was not hired under the London Agreement, which would have subjected his salary to U. S. tax.

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Court’s Reasoning

The court interpreted Article 19 of the Ottawa Agreement, which provides that officials of NATO are exempt from taxation on salaries paid by NATO unless a member state employs and pays its nationals under a specific arrangement. The court emphasized that the U. S. had such an arrangement (the London Agreement) but Amaral was not hired under it. The court rejected the Commissioner’s argument that the U. S. could tax its nationals regardless of the hiring arrangement, citing the clear language of the treaty and the intent of the signatories. The court noted that the U. S. intended to tax its nationals through the mechanism provided in Article 19, not by disregarding it. The court also considered the State Department’s consistent interpretation of the treaty, which treated the first sentence of Article 19 as operative even after the London Agreement was in place. The decision underscores the importance of adhering to the text of international agreements and the role of diplomatic negotiations in resolving disputes over treaty interpretation.

Practical Implications

This decision clarifies that U. S. citizens directly employed by NATO are exempt from U. S. taxation on their salaries unless they are hired under a specific secondment arrangement like the London Agreement. It reinforces the principle that clear treaty language must be followed and that the U. S. must use the mechanisms provided in treaties to assert taxing jurisdiction over its nationals working abroad. Legal practitioners should carefully review the terms of international agreements when advising clients on the tax implications of foreign employment. This ruling may influence how other countries interpret similar provisions in their treaties with international organizations. Subsequent cases involving the tax treatment of international employees should consider this precedent when analyzing the applicability of treaty provisions.

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