Specking v. Commissioner of Internal Revenue, 117 T. C. 95 (2001)

In *Specking v. Commissioner*, the U. S. Tax Court ruled that income earned by U. S. citizens on Johnston Island, a U. S. insular possession, could not be excluded from gross income under Sections 931 or 911 of the Internal Revenue Code. The court clarified that post-1986 amendments to Section 931 limited the exclusion to income from specified possessions—Guam, American Samoa, and the Northern Mariana Islands—excluding other U. S. territories like Johnston Island. This decision underscores the restrictive nature of tax exclusions and impacts how income from various U. S. territories is treated for tax purposes.

Parties

Plaintiffs-Appellants: Joseph D. Specking, Eric N. Umbach, and Robert J. Haessly. Defendant-Appellee: Commissioner of Internal Revenue.

Facts

Joseph D. Specking, Eric N. Umbach, and Robert J. Haessly were U. S. citizens employed by Raytheon Demilitarization Co. on Johnston Island, a U. S. insular possession located in the Pacific Ocean, during the tax years 1995-1997. They lived and worked on the island, which is under the operational control of the Defense Threat Reduction Agency and has no local government or native population. The petitioners claimed that their compensation earned on Johnston Island should be excluded from their gross income under either Section 931 or Section 911 of the Internal Revenue Code. Section 931 allows for exclusion of income from certain U. S. possessions, while Section 911 provides for exclusion of foreign earned income. The Commissioner of Internal Revenue determined deficiencies in the petitioners' federal income taxes, arguing that the income was not excludable under either provision.

Procedural History

The petitioners filed separate petitions to redetermine the deficiencies determined by the Commissioner in notices issued on April 1, 1999, April 13, 1999, and June 9, 1999. The cases were consolidated for briefing and opinion by the U. S. Tax Court. The court reviewed the case de novo, as it is a court of original jurisdiction in tax disputes.

Issue(s)

Whether the petitioners may exclude from gross income under Section 931 of the Internal Revenue Code the compensation they received during the years in issue for services performed on Johnston Island, an unorganized, unincorporated U. S. insular possession?

Whether the petitioners may alternatively exclude from gross income under Section

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911 of the Internal Revenue Code the compensation they received during the years in issue for services performed on Johnston Island?

Rule(s) of Law

Section 61(a) of the Internal Revenue Code defines gross income broadly as all income from whatever source derived. Exclusions from income are construed narrowly, and taxpayers must bring themselves within the clear scope of the exclusion. Section 931, as amended by the Tax Reform Act of 1986, allows for the exclusion of income derived from sources within specified possessions—Guam, American Samoa, and the Northern Mariana Islands—for bona fide residents of those possessions. Section 911 provides for the exclusion of foreign earned income for qualified individuals with a tax home in a foreign country.

Holding

The U. S. Tax Court held that the petitioners could not exclude their compensation earned on Johnston Island from gross income under either Section 931 or Section 911 of the Internal Revenue Code. The court determined that Johnston Island did not qualify as a specified possession under the amended Section 931 and that it did not constitute a foreign country for purposes of Section 911.

Reasoning

The court analyzed the amendments to Section 931 made by the Tax Reform Act of 1986, which became effective for tax years beginning after December 31, 1986. These amendments limited the exclusion to income from specified possessions, and Johnston Island was not included among them. The court rejected the petitioners' argument that the old version of Section 931 remained in effect, finding that the statutory language and legislative history clearly indicated Congress's intent to limit the exclusion to the specified possessions.

Regarding Section 911, the court found that Johnston Island did not meet the definition of a foreign country as it is a territory under the sovereignty of the United States. The court also rejected the petitioners' reliance on a regulation under Section 931 that suggested a connection between Sections 911 and 931, finding that the regulation was obsolete and superseded by the legislative regulations under Section 911.

The court considered the policy behind the amendments to Section 931, which aimed to enable the specified possessions to enact their own tax laws and prevent them from being used as tax havens. The court also noted the narrow construction of exclusions from income and the requirement that taxpayers prove their income is specifically exempted.

Disposition

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The U. S. Tax Court entered decisions for the respondent (Commissioner of Internal Revenue) in docket Nos. 12010-99 and 12348-99. In docket No. 14496-99, the court entered a decision under Rule 155.

Significance/Impact

The decision in *Specking v. Commissioner* clarifies the scope of Sections 931 and 911 of the Internal Revenue Code, particularly in relation to income earned in U. S. territories not specified in the amended Section 931. It reinforces the principle that exclusions from income are to be narrowly construed and that taxpayers must meet specific statutory requirements to claim them. The case has implications for U. S. citizens working in U. S. territories other than Guam, American Samoa, and the Northern Mariana Islands, as it confirms that income from those territories is not eligible for exclusion under Section 931. Furthermore, it underscores the importance of legislative regulations in interpreting tax statutes and the need for taxpayers to carefully consider the definitions of terms such as “foreign country” when claiming exclusions under Section 911.

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