John A. Francisco v. Commissioner of Internal Revenue, 119 T. C. 317 (U. S. Tax Court 2002)

In Francisco v. Comm'r, the U. S. Tax Court ruled that the Section 931 exclusion applies to American Samoa residents without specific regulations, but income earned in international waters by a U. S. citizen residing in American Samoa is U. S. source income, not excludable. The decision underscores the complexities of tax jurisdiction and source rules in international waters, impacting U. S. citizens working in U. S. territories.

Parties

John A. Francisco, the Petitioner, was the plaintiff at the trial level before the U. S. Tax Court. The Commissioner of Internal Revenue was the Respondent and defendant. Both parties maintained their respective roles throughout the litigation.

Facts

John A. Francisco, a U. S. citizen, resided in American Samoa during the years in issue (1995, 1996, and 1997). He was employed as the chief engineer on the M/V Sea Encounter, a fishing vessel operated by De Silva Sea Encounter Corp. , a Nevada corporation. Francisco's primary duties included maintaining the ship's engine and machinery, which was crucial for the vessel's fishing operations in international waters. The vessel's fishing trips, which lasted from 3 weeks to 3 months, began and ended in American Samoa, where the entire catch was sold to Van Camp Seafood Co. under an exclusive contract. Francisco earned income based on the tonnage of fish caught, receiving payment in American Samoa. On his tax returns for the years in issue, Francisco excluded his wage income under Section 931 of the Internal Revenue Code, which excludes income derived from sources within, or effectively connected with a trade or business in, American Samoa.

Procedural History

The Commissioner determined deficiencies in Francisco's federal income taxes for the years 1995, 1996, and 1997, along with accuracy-related penalties, which Francisco contested. The case was brought before the U. S. Tax Court, where Francisco sought a determination of his tax liability. The court's standard of review was de novo, as it involved the interpretation of tax law and regulations. The case was reviewed by the full court, with a majority opinion issued along with a concurrence and a dissent.

Issue(s)

1. Whether the Section 931(a) exclusion applies to residents of American Samoa even though the Secretary has not issued regulations under Section 931(d)(2)?
2. Whether income earned by Francisco from performing personal services in international waters is American Samoan source or effectively connected income, or

© 2025 SCOTUSreports.com. All rights reserved.

U. S. source income?
3. Whether Francisco must include in gross income the amount of State income tax refunds he received in 1995 and 1996?

Rule(s) of Law

Section 931(a) of the Internal Revenue Code excludes from gross income the income of a bona fide resident of American Samoa derived from sources within American Samoa or effectively connected with the conduct of a trade or business in American Samoa. Section 931(d)(2) states that the determination of whether income is described in Section 931(a) shall be made under regulations prescribed by the Secretary. Section 863(d) provides that income earned by U. S. persons from personal services performed in an ocean-based activity is U. S. source income.

Holding

1. The court held that the Section 931(a) exclusion applies to residents of American Samoa even in the absence of regulations under Section 931(d)(2).
2. Income earned by Francisco for services performed in international waters is U. S. source income under Section 863(d), not American Samoan source or effectively connected income under Section 931(a).
3. Francisco must include in gross income the amount of State income tax refunds he received in 1995 and 1996.

Reasoning

The court reasoned that the statutory language of Section 931(a) provides the exclusion independently of the regulatory authority in Section 931(d)(2), and the legislative history supports the application of the exclusion without specific regulations. The court rejected the dissenting view that the absence of regulations nullifies the exclusion, citing prior cases where the failure to issue regulations did not bar the application of beneficial tax provisions.

For the second issue, the court applied Section 863(d), enacted in 1986, which sources income from ocean-based activities performed by U. S. persons as U. S. source income. The court found that Francisco, as a U. S. citizen, was a U. S. person, and thus his income earned in international waters was U. S. source income, not excludable under Section 931(a). The court also considered but rejected Francisco’s arguments based on Section 1. 863-6 of the Income Tax Regulations, which applies the principles of Sections 861-863 to determine income sourced in possessions but does not incorporate the changes made by Section 863(d).

Regarding the third issue, the court applied the tax benefit rule, finding that Francisco must include the State tax refunds in his gross income because he received a tax benefit from the deductions in the years they were claimed.

The court addressed policy considerations, noting that Congress intended to prevent

© 2025 SCOTUSreports.com. All rights reserved.

tax abuse and ensure that U. S. citizens residing in possessions remain subject to U. S. taxation on income from sources outside the possessions. The court also considered the legislative intent behind Section 863(d) to prevent manipulation of foreign tax credits and the absence of regulations under Section 931(d)(2) as not precluding the application of Section 931(a). The dissenting opinion argued for a strict interpretation of Section 931(d)(2), asserting that without regulations, the exclusion could not be applied, but the majority found this view inconsistent with the statutory text and legislative intent.

Disposition

The court entered a decision under Rule 155, which requires the parties to compute the amount of tax due based on the court's holdings.

Significance/Impact

The decision in Francisco v. Comm'r clarifies that the Section 931 exclusion for American Samoa residents applies even in the absence of specific regulations, aligning with the principle that the absence of regulations does not bar beneficial tax provisions. However, it also establishes that income earned by U. S. citizens in international waters remains subject to U. S. taxation, impacting the tax treatment of income earned by residents of U. S. territories engaged in ocean-based activities. The case has implications for tax planning and compliance for U. S. citizens working in U. S. territories and highlights the ongoing need for regulatory guidance on the application of Section 931 to prevent tax abuse and clarify income sourcing rules.

© 2025 SCOTUSreports.com. All rights reserved.