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15 April 1954

Office of General Counsel

Income Tax Obligation of

1. In reply to your memorandum of 12 April 1954 on subject, the following is provided for your guidance:

a. A U. S. citizen is taxed on all income "throughout the world regardless of source, except for:

(1) Earned income from personal services abroad when he has a bona fide foreign residence for an entire tax year; or

(2) Earned income from personal services abroad up to \$20,000 when he has resided in a foreign country or countries for 510 full days in any period of 18 consecutive months.

But note that:

(1) "Earned income" does not include any payments which are distributions of earnings or profits except in cases when he is engaged in a trade or business in which both capital and personal services are "material income producing factors," then a reasonable allowance as compensation for the personal services, not over 20% of the share of profits, shall be considered as "earned income."

(2) None of the above applies to payments by the United States or any of its agencies. All such payments are taxable regardless of foreign residence.

b. Thus all income, except as limited above, is taxable to United States citizens regardless of source. This includes: bond interest, stock dividends, rents, royalties, annuity payments, partnership income, and miscellaneous. It includes gains on the sale of capital assets (personal property of the taxpayer - i.e., automobile, etc. - among other things).

c. The exemption for earned income from services abroad does not apply to resident aliens. This, of course, is entirely logical, and is mentioned only because our Agency occasionally arranges for aliens who are in fact "non-resident" to preserve their technical "resident" status for purposes of ultimate citizenship.

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d. Credit or deduction for foreign income taxes is allowed against the United States tax within certain limitations.

e. Non-resident aliens, on the other hand, are liable for United States tax only on certain income (including capital gains) from sources within the United States. (He would not, incidentally, be taxed on income from the United States Government for services abroad.) As a non-resident alien, this tax liability would depend on certain artificial criteria depending on whether he is engaged in a "trade or business" in the United States and if he is not so engaged, whether his income is greater or less than \$15,400. It also depends on the specific provisions of any treaty between the United States and his native country. His deductions and exemptions on such income vary with his status.

f. For this tax obligation as a citizen on payments by the United States, we would suggest that he attribute them to some foreign source for which there is no need to withhold United States tax or file an information return. This could best be accomplished by business income (in the form of profits or dividends) from a legitimate or spurious foreign employer. From the facts at hand, "dividends" spread among his shipping firm and other businesses would appear preferable for purposes of his final return. The Declaration of Estimated Income does not require disclosure of the source of income, only the amount of the tax. As an alien, he would not be required to pay a United States tax on payments from the Agency for services performed abroad.

2. If we can be of any further assistance, please advise us.

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Assistant General Counsel

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