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Tax Court & Board of Tax Appeals Reported Decisions

DOUGLAS J. LEMERY, 54 TC 480

Douglas J. Lemery, Petitioner v. Commissioner of Internal Revenue, Respondent

Case Information:

[pg. 480]

Code Sec(s):	
Docket:	Docket No. 2306-67.
Date Issued:	03/12/1970
Judge:	Opinion by FORRESTER, <i>J.</i>
Tax Year(s):	Year 1964.
Disposition:	Deficiencies redetermined.

HEADNOTE

1. NONRESIDENT ALIENS—Definition and taxation—alien's loss of residence. Capital gains tax imposed on stock sale by Canadian-born resident U.S. resident: U.S.-Canada Tax Treaty inapplicable. IRS proved residency; Canadian declared resident intent on visa application, stayed in U.S. 6 years with children enrolled in American schools, filed Form 1040 and not 1040B for non-resident aliens, took deductions for local taxes and contributions

to American charities. Because contradictory Reg. took precedence over ruling, Canadian couldn't prove non-residence by showing intention to leave U.S.A.



Reference(s): 1970 P-H Fed. ¶ 30,214(80); 30,216(5)(75); 41,459; 42,160.

2. ADDITIONS TO TAX AND PENALTIES — Negligence penalty — mistaken interpretation of law or fact. Negligence penalty not imposed on Canadian-born resident for failure to pay capital gains tax on stock sale. It wasn't negligent for him to rely on U.S.-Canada Tax Treaty, and on administrative ruling definition of non-residency which superior Reg. nullified.

Reference(s): 1970 P-H Fed. ¶ 30,216(5)(75); 37,269(5)(10); 41,459; 42,160.

Syllabus

Official Tax Court Syllabus

Petitioner, a Canadian citizen, realized a capital gain while living in the United States. In reliance upon O.D. 468, 2 C.B. 243 (1920), and article VIII of the Income Tax Convention and Protocol between the United States and Canada, 56 Stat. 1399, he did not report the gain on the Nonresident Alien Income Tax Return form which he filed for the short year of his departure. Respondent contends, *inter alia*, that the O.D. applies only to a jeopardy assessment procedure available to respondent. *Held:* Even assuming that petitioner is correct in contending that the O.D. applies generally to the treaty's terms, it has been in direct conflict with  sec. 1.871-5, Income Tax Regs. (and the predecessors of that section), at all relevant times. [pg. 481] The regulation is a reasonable interpretation of the law and must prevail over the O.D. *Held, further,* under the circumstances of this case, petitioner is not liable for the additions to the tax under  sec. 6653(a), I.R.C. 1954.

Counsel

Roger E. Lageschulte, for the petitioner.

Stephen E. Silver, for the respondent.

Forrester, *Judge:*

Respondent determined deficiencies in income tax and additions thereto as follows:

Year	Deficiency	Sec. 6653(a)
1964	\$34,985.52	\$1,749.28

The issues to be decided herein are: (1) Whether petitioner's long-term capital gains from the sale of stock are exempt from income tax under article VIII of the Income Tax Convention and Protocol between the United States and Canada, Mar. 4, 1942, as amended;¹ and (2) whether petitioner is liable for additions to the tax under section 6653(a).²

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation and exhibits attached thereto are incorporated herein by this reference.

Douglas J. Lemery (hereinafter sometimes referred to as Douglas) is the petitioner herein and at the time of the filing of his petition was both a citizen and resident of the Dominion of Canada.

On April 4, 1951, Douglas applied for and was granted an immigration visa at Vancouver, British Columbia, Canada. On Form 256a,³ "Application for Immigrant Visa and Alien Registration," Douglas stated that his intention was to reside in the United States permanently and to join the McCulloch Motor's Corp. at Los Angeles, Calif., as a sales manager.

Douglas was classified as a nonquota immigrant and on the same date, April 4, 1951, entered the United States at Seattle, Wash. Douglas stayed in the United States for about 6 months and then returned to Canada.

On September 4, 1958, Douglas again entered the United States as a nonquota immigrant. On Form 256a, "Application for Immigrant[pg. 482] Visa and Alien Registration," Douglas stated that his purpose in entering the United States was to reside permanently. Douglas was issued a permanent-resident card at the time of entrance (Form I-151).

On September 26, 1958, Douglas and his wife, Marguerite, purchased a home at Bellevue, Wash. He and his wife lived at that address until June 1964, when they moved to Victoria, British Columbia, where they have since resided.

Douglas and his wife had three children, Thomas J., Sally, and Charles R. During the 1963-64 school year Charles was enrolled in elementary school in the Bellevue public school system. He was continuously enrolled from kindergarten in 1960 until the end of the 1963-64 school year on June 4, 1964. Sally was enrolled in high school in the Bellevue public school

system during the 1963-64 school year. She was first enrolled in the Bellevue public school system on September 4, 1962, and was in continuous enrollment until June 4, 1964. Thomas was graduated from Bellevue high school on June 4, 1962. He was continuously enrolled in the Bellevue public school system from 1958 until his graduation in 1962. At the end of the 1963-64 school year Sally withdrew from the Bellevue public schools. A copy of her pupil record was sent to a high school in Victoria, British Columbia, Canada. Sally reentered the Bellevue public schools during the 1965-66 school year and was graduated therefrom at the end of the first semester.

It was the policy of the Bellevue public schools to enroll only those pupils whose responsible parent or guardian physically resided in a private home or apartment located within the boundaries of the school district. An exception was made to this policy when a special waiver was granted by the superintendent of schools or his designee. No such waiver was granted in connection with the enrollment of either Charles or Sally for the 1963-64 school year. Moreover, no such waiver was granted for Sally during the first semester of the 1965-66 school year.

Prior to June 30, 1963, petitioner acquired 59,543 shares of common stock in Code-A-Phone Electronics, Inc. (hereinafter sometimes referred to as Code-A-Phone), a corporation organized under the laws of the State of Washington. At all times herein concerned, said shares were evidenced by stock certificate No. 191 for 31,666 shares and stock certificate No. 192 for 27,877 shares.

On February 24, 1964, Douglas granted to Jack E. Snodgrass (hereinafter sometimes referred to as Jack) two separate options to purchase the 59,543 shares of Code-A-Phone.

The first option provided that Jack could purchase on or before March 9, 1964, the 31,666 shares of Code-A-Phone represented by certificate No. 191 for \$134,580.50. Douglas was paid \$500 as consideration [pg. 483] for the option. If the option was exercised the \$500 was to be applied to the purchase price.

The second option, which was also granted for \$500, and which was subsequently amended on February 27, 1964, provided that Jack could purchase the 27,877 shares of Code-A-Phone represented by certificate No. 192 on or before March 9, 1964. If the second option was exercised, that \$500 was also to be applied to the purchase price.

Escrow accounts were set up with a Seattle bank for both options.

The first option was exercised on March 3, 1964. On March 9, 1964, Douglas received \$134,080.50 in full payment of the balance of the purchase price for the 31,666 shares of Code-A-Phone.

In accordance with the terms of the second option, as amended, Douglas received \$500 on February 24, 1964, \$5,000 on March 9, 1964, and \$119,946.50 on February 25, 1965, and petitioner admits that he realized a long-term capital gain of \$140,080.50 from his Code-A-Phone stock during February and March of 1964.

Douglas' residence at Bellevue was first listed for sale with a broker in April of 1964. On May 4, 1964, Douglas gave two real estate agents an exclusive real estate listing to sell the residence. The listing was renewed on June 10, 1964, and November 11, 1964. The residence was eventually sold in December 1965.

For the calendar years 1961 and 1962, Douglas and his wife filed a joint Federal income tax return on Form 1040 with the district director of internal revenue, Tacoma, Wash., in which their address was shown therein as Bellevue, Wash. For the calendar year 1963, Douglas filed an individual Federal income tax return on Form 1040 with the district director, Tacoma, Wash., in which he claimed an exemption for his wife and in which he listed his address as Bellevue, Wash. Douglas had obtained a social security number which was used on all of his U.S. income tax returns.

On his tax returns for the years 1961 through 1963, Douglas claimed deductions in each or some of the years for: (1) Contributions to a Bellevue church, American Cancer Society, Muscular Dystrophy, March of Dimes, and Red Cross; (2) real estate taxes and auto licenses; and (3) a safe-deposit box. During the years 1961 through 1963, Douglas reported interest income from a Seattle bank.

On June 12, 1964, Douglas surrendered to Canadian immigration officers his Form I-151, Permanent Residence Card. At that time petitioner was admitted to Canada for permanent residence. Douglas did not comply with the requirements of section 6851(d)(1) before departing from the United States to Canada in June 1964, by filing a U.S. Departing Alien Income Tax Return (Form 1040C), with the district director of internal revenue in the district in which he resided.[\[pg. 484\]](#)

For the short period, January 1, 1964, to May 31, 1964, Douglas filed a U.S. Nonresident Alien Income Tax Return, Form 1040B, dated April 15, 1965, and mailed on April 20, 1965, with the Director of International Operations, Internal Revenue Service, Washington, D.C., showing his address as Victoria, British Columbia, Canada.

Before filing this return petitioner had been advised by his Canadian chartered accountant that he could probably establish that Canada was his residence in 1964 and consequently it would be all right not to report his Code-A-Phone profit on his U.S. return. On Douglas' Form 1040B there was reported interest income of \$2,912 as his total income. Accompanying the return was the following letter:

3215 Ripon Road, Victoria, B.C.,

Canada

12 April, 1965

Director of International Operations
U.S. Treasury Department
Internal Revenue Service
Washington, D.C. 20225
U.S.A.

Dear Sirs,

During 1964 I earned interest of \$2,912.00 from a source within the United States of America. At the time of receipt the full amount of income was paid me as I resided in Seattle, Washington.

I am a Canadian citizen and returned to Canada in May, 1964.

Pursuant to the U.S.--Canada Tax Convention, I will file a Canadian income tax return for 1964. However, under that same statute I am liable for a 15% tax on investment income earned in the United States.

I am enclosing:

(a) U.S. Nonresident Alien Income Tax Return--1040B;

(b) A cheque in the amount of \$437.00 (U.S.) for 1964 U.S. income taxes.

If you require any further information, please do not hesitate to contact me at the above address.

Yours very truly,

(Signed) D. J.

Lemery

D. J.

Lemery

On page 2 of Douglas' Form 1040B the following question was answered in the negative:

7. Have you excluded from gross income in this return any amount derived from sources within the United States?

Also on page 2 of Douglas' Form 1040B were the following questions:

8. If the benefits of an income tax convention are claimed, furnish the following information:
(Country) ___

Type and amount of income claimed to be exempt ___

Question 8 was answered "Canada" and "Investment Income", respectively.

On November 4, 1965, respondent, in form letter FL-24A addressed to Douglas J. and Marguerite H. Lemery, Victoria, British Columbia, [pg. 485] Canada, informed petitioner that respondent could not locate petitioner's income tax return for the taxable year 1964. In reply to respondent's letter of November 4, 1965, Douglas' accountants in Canada stated that Douglas had filed a Form 1040B, Nonresident Alien Income Tax Return, with the Director of International Operations for the year 1964. On February 23, 1966, respondent informed Douglas that his Form 1040B, Nonresident Alien Income Tax Return for 1964, was being audited. Respondent requested information concerning the sale of the shares of Code-A-Phone.

Respondent did not get a reply to his letter of February 23, 1966, and on March 7, 1966, again requested information concerning the sale of the stock. In a letter dated March 14, 1966, from Douglas' accountants, respondent was told that the requested information would be forthcoming in a "few days." In a letter from respondent dated April 11, 1966, to Douglas, the information concerning the sale of the stock was again requested. In a letter dated April 18, 1966, Douglas advised respondent that his accountants would be "in touch with [respondent] in the next few days." In a letter from respondent to Douglas dated May 3, 1966, Douglas was informed that his accountants had not contacted respondent as promised in his earlier correspondence of April 18, 1966. Douglas, in a letter dated May 11, 1966, to respondent, indicated that he had requested his accountants to contact the respondent immediately by phone. On May 13, 1966, petitioner's accountants contacted the examining agent by telephone, at which time respondent was informed that petitioner's position would be explained in a letter to be forthcoming.

On December 13, 1966, respondent, by statutory notice, determined: (1) That Douglas realized and was taxable on a long-term capital gain in the amount of \$140,080.50 from the sale of Code-A-Phone shares; and (2) that part of the underpayment of tax the taxable year ended December 31, 1964, was due to negligence or intentional disregard of rules and regulations under section 6653(a).

OPINION

During the calendar year 1964 petitioner received \$140,080.50 in exchange for shares of stock of Code-A-Phone. Respondent determined that 50 percent of the amount received was taxable as a long-term capital gain (sec. 1202).⁴ Petitioner, however, contends that he is exempt from the tax on capital gains under article VIII of the Income Tax Convention and Protocol between the United States and [pg. 486]Canada, March 4, 1942, as amended, 56 Stat. 1399 (effective Jan. 1, 1941) (hereinafter sometimes referred to as treaty), and respondent concedes that under Code sections 894 and 7852(d), petitioner must prevail if article VIII of the treaty is applicable to the facts of the instant case.

Article VIII of the treaty provides:

Gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State.

The regulations promulgated under article VIII of the treaty provide, *inter alia*, that the—
gain derived from the sale or exchange within the United States of capital assets by a *nonresident alien individual resident in Canada* *** is exempt from Federal income tax *** [Emphasis supplied.]⁵

Accordingly, before an individual may claim immunity under the treaty from income tax on the gain derived from the sale or exchange of a capital asset, it must be established that he is a nonresident alien. See *William E. Adams*, 46 T.C. 352, 362. Thus, as recognized by both petitioner and respondent, the applicability of article VIII of the treaty is dependent upon whether the petitioner was a nonresident alien.⁶

Although, as a general rule, the burden of proof in this Court is upon the petitioner,⁷ an alien, by reason of his alienage, is presumed to be a nonresident alien. [pg. 486] Sec. 1.871-4(b), Income Tax Regs. The presumption, however, may be overcome by proof of acts and statements of

the alien demonstrating an intention to acquire residence in the United States or by proof that his stay in the United States has been of such an extended nature as to constitute him a resident. [§] Sec. 1.871-4(c)(2)(iii), Income Tax Regs. Thus, the effect of the presumption is to relieve the petitioner at the outset from establishing that he is a non-resident alien. The burden of proof, however, is not shifted; the petitioner must meet the respondent's counterproof and go forward to make good his total case.

As noted earlier a nonresident alien is an individual whose residence is not within the United States and who is not a citizen of the United States. [§] Sec. 1.871-2(a), Income Tax Regs. In defining residence we are guided by [§] section 1.871-2(b), Income Tax Regs., which provides: [pg. 487]



Sec. 1.871-2 Determining residence of alien individuals.


(b) *Residence defined.* An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but, if his purpose is of such a nature that an extended stay may necessary for its accomplishment, and to that end alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.

Petitioner does not directly contend that he had not become a resident of the United States prior to the year in issue, but places his reliance on O.D. 468 which is discussed *infra*. In light of the above regulations and the facts of the instant case it is very clear that he had acquired residency.

We base this finding on the entire record, and particularly upon (1) petitioner's statement in his visa application that his purpose in entering the United States in 1958 was to reside permanently; (2) that petitioner and his wife physically resided in Bellevue, Wash., from September of 1958 until June of 1964; (3) that petitioner's son Thomas was continuously enrolled in the Bellevue school system from 1958 until graduation in 1962; (4) that petitioner's Charles was continuously enrolled in the Bellevue public school system from kindergarten in

1960 until the end of the 1963-64 school year on June 4, 1964; (5) that petitioner's daughter Sally first enrolled in the Bellevue public schools on September 4, 1962, and was in continuous enrollment thereafter until June 4, 1964; (6) petitioner did not maintain another residence outside of the United States from 1958 to 1964; (7) for the years 1961 through 1963, Form 1040 was filed by petitioner (U.S. Individual Income Tax Return); as opposed to Form 1040B (U.S. Nonresident Alien Income Tax Return); (8) petitioner has a social security number; (9) his income tax returns for 1961 through 1963 showed in each some of the years contributions to a church in Bellevue, American Cancer Society, Muscular Dystrophy, March of Dimes, and Red Cross; (10) petitioner, in his income tax returns for 1961 through 1963, also claimed deductions for real estate taxes, auto licenses, and a safe-deposit box, all located in the State of Washington.[pg. 488]

Thus, we find and hold that petitioner did have a residence within the United States; moreover,  section 1.871-5, Income Tax Regs.,⁸ provides that once an alien acquires a residence in the United States, an intention to change that status is not enough. He retains his status as a resident until he abandons that residence and actually departs from the United States. *Josette J. Verrier Friedman*,  37 T.C. 539, 553 (1961). Therefore, we find and hold further that petitioner was not a nonresident alien for the period January 1, 1964, to June 12, 1964.





In arguing that for the calendar year 1964 he should be considered as a nonresident alien petitioner relies on O.D. 468, 2 C.B. 243-244 (1920), which is set forth in the margin.⁹ It is respondent's contention that O.D. 468, which was published in 1920, is both obsolete¹⁰ and in conflict with regulations section 1.871-5, *supra*. He argues that the office decision is obsolete because, as shown by its heading, it was published under that section of the 1918 Revenue Act which has now become section 6851(a) of the Code. Under the 1918 Act the Commissioner, in order to prevent acts tending to prejudice collection was empowered to declare the taxable year of a taxpayer terminated "at the end of the calendar month then last past." In 1921 the quoted provision was changed to "shall declare the taxable period *** immediately terminated," which phrase has been carried forward to  section 6851(a) of the 1954 Code. Respondent concludes that O.D. 468 had reference to this "jeopardy" procedure and has thus been obsolete since the 1921 change.

While we are inclined to agree with respondent's reasoning and conclusion, there is a more compelling reason for arriving at the same result, i.e., that petitioner is taxable as a resident for the year in issue. Article 313 (sec. 217), Regs. 62 (1922), was identical to present regulations section 1.871-5, *supra*, except for a concluding sentence which did not change its

meaning. In section 19.211-5, Regs. 103 [pg. 489](1940), this last sentence was dropped and the regulation has remained unchanged to the present time.

It is obvious that the regulation and the office decision are in direct conflict if we accept petitioner's premise that the office decision applied generally to the provisions of the treaty. This in itself is a strong argument in favor of respondent's position that the office decision was applicable only to the jeopardy situation, but more importantly, petitioner cannot prevail even if we accept his premise.

The office decision and the regulation were both in existence when the treaty was adopted, during the year in issue, and at all times in between. They were in direct conflict, and as between the two the regulation must take precedence.

Treasury regulations, addressed to and adopted to the enforcement of a revenue statute, have the force and effect of law if said regulations are not unreasonable and plainly inconsistent with the statute. See, e.g., *Helvering v. Winmill*,  305 U.S. 79, 83 (1938). An office decision, however, does not have the force and effect of a Treasury regulation; *Helvering v. N.Y. Trust Co.*,  292 U.S. 455, 468 (1934), since each ruling in effect represents only the conclusion of the Internal Revenue Service as to the application of law to certain specified facts.  Rev. Proc. 67-1, sec. 13.10, 1967-1 C.B. 554.¹¹ Accordingly, since as a general rule resident aliens are taxable the same as citizens of the United States, *Josette J. F. Verrier Friedman, supra* at 551; secs. 1.6012-1(a)(ii), 1.871-1,  1.1-1(b), Income Tax Regs.; we find and hold that petitioner is taxable on the \$140,080.50 long-term capital gain realized in 1964 from the of Code-A-Phone shares.

Respondent determined additions to the tax under section 6653(a). This addition to the tax is imposed when any part of the underpayment [pg. 490] of tax is due to negligence or intentional disregard of rules and regulations.

We have examined the record herein with great care, and have included many salient facts bearing on this issue in our findings. Many of these facts are unfavorable to petitioner, but while the issue is not free from doubt, we feel that O.D. 468, *supra*, created such confusion and uncertainty on the question of this petitioner's residence that we cannot say his actions were due to "negligence or intentional disregard of rules and regulations."

Decision will be entered under Rule 50.


¹ 56 Stat. 1399 (effective Jan. 1, 1941).

² All references herein are to the Internal Revenue Code of 1954 unless otherwise indicated.

³ Form 256a, "Application for Immigrant Visa and Alien Registration," is filed by an immigrant who wishes to become a permanent resident of the United States. A nonquota immigrant who has filed Form 256a is permitted to work in the United States. An immigrant who obtains entry under Form 256a may make temporary visits outside the United States for periods of up to 1 year without obtaining a new visa. An immigrant is required to have a permanent residence card (Form I-151) in his possession at all times. The permanent-resident card contains the name of the immigrant, date of birth, alien registration number, date of entry into the United States, and a picture of the alien.

⁴ Respondent's notice of deficiency did not take into account petitioner's basis in Code-A-Phone, Petitioner has indicated that because his basis in the stock is *de minimis* he will not contest this issue.

⁵ Regulations under Tax Conventions, Canada, 26 C.F.R. sec. 519.110(a).

⁶ A nonresident alien as defined by  sec. 1.871-2(a), Income Tax Regs., is an "individual whose residence is not within the United States, and who is not a citizen of the United States."

⁷ Rule 32, Tax Court Rules of Practice.

⁸ Sec. 1.871-5 Loss of residence by an alien.

An alien who has acquired residence in the United States retains his status as a resident until he abandons the same and actually departs from the United States. An intention to change his residence does not change his status as a resident alien to that of a nonresident alien. Thus, an alien who has acquired a residence in the United States is taxable as a resident for the remainder of his stay in the United States.

⁹ "Section 250, Article 1013: Declaration of termination of taxable period


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(Also Section 217, Article 312.)

O.D. 468

"The status of an alien leaving the United States during the taxable year is determined by his status on the last day of his taxable period. The taxable period is the interval between January 1 and the last day of the month preceding his departure. If the alien had formed no intention of leaving the United States by such date he will be taxed as a resident alien. If, however, his intention to depart was formed prior to the last day of the month preceding departure, he will be as a nonresident alien for such period. *** "

¹⁰ O.D. 468 was declared obsolete by  Rev. Rul. 68-674, C.B. 609. The effect of this declaration is to indicate that such rulings will no longer be determinative with respect to future transactions. See Rev. Proc. C.B. 576.

¹¹ See also the caveat at the front of all Cumulative Bulletins. On 2 C.B. (January-June 1920) it reads as follows:

"The INCOME TAX RULINGS constitute a service of information from which taxpayers and their counsel may obtain the best available indication of the trend and tendency of official opinion in the administration of the income and profits tax provisions of the Revenue Acts. The rulings have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of law which has not been formally approved and promulgated by the Secretary of the Treasury. Each ruling embodies the administrative application of the law and Treasury Decisions to the entire state of facts upon which a particular case arises. It is especially to be noted that the same result will not necessarily be reached in another case unless all the material facts are identical with those of the reported case. As bearing it is not always feasible to publish a complete statement of the facts underlying each ruling, there can be no assurance that any new case is identical with the reported case. As bearing out this distinction, it may be observed that the rulings published from time to time may appear to reverse rulings previously published.

"Officers of the Bureau of Internal Revenue are especially cautioned against reaching a conclusion in any case merely on the basis of similarity to a published Income Tax Ruling, and should base their judgment on the application of all pertinent provisions of the law and Treasury Decisions to all of the facts in each case. The Income Tax Rulings should be used merely as aids in studying the law and the Treasury Decisions."

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