THE TAX COURT SMILES ON THE FOREIGN-EARNED INCOME OF COMMUNITY PROPERTY TAXPAYERS: *ROBERT R. BOTTOME*

> Sometimes the Sense is more confined and contracted than the Letter, and sometimes it is more large and extensive.[1]
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> There is no surer guide in the interpretation of a statute than its purpose when that is sufficiently disclosed; nor any surer mark of over solicitude for the letter than to wince at carrying out that purpose because the words used do not formally quite match with it.[2]

It is the design of this comment to delve into the history, scope and purpose of section 911 of the Internal Revenue Code[3] and, in particular, of subsection 911(c)(3).[4] This inquiry will be made in conjunction with a critical analysis of the Tax Court's decision in *Robert R. Bottome*,[5] a decision which results in unequal treatment of taxpayers domiciled in community property states and non-community property states.[6]

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1. Eyston v. Studd, 2 Plowden 459, 465 (1573).
2. Federal Deposit Ins. Corp. v. Tremaine, 133 F.2d 827, 830 (2d Cir. 1943) (opinion by Judge Learned Hand).
3. INT. REV. CODE OF 1954, § 911. The portions of § 911 relevant to this inquiry provide, in substance, that a United States citizen who is a bona fide resident of a foreign country for an entire taxable year and who has earned income from sources other than the United States or an agency thereof may exclude from his gross income an amount not to exceed $20,000 for the taxable year.
4. *Id.* § 911(c)(3). Section 911(c)(3) provides in pertinent part:
> (3) TREATMENT OF COMMUNITY INCOME.— . . . with respect to amounts received for services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount excludable . . . from the gross income of such husband and wife shall equal the amount which would be excludable if such amounts did not constitute such community income.
5. 58 T.C. 212 (1972), *aff'd without opinion*, 486 F.2d 1314 (D.C. Cir. 1973).
6. At the outset the current Congressional effort to repeal the earned-income exclusion of § 911, as revealed in the May 20, 1974, press release of the House Ways and Means Committee, should be noted:
> The committee began its consideration of various provisions in the tax laws dealing with the treatment of foreign income earned by U.S. taxpayers . . . . The provisions tentatively agreed to by the committee today are as follows:

The problem attacked by the court in *Bottome* may be brought into sharp focus through the utilization of a hypothetical factual situation so as to eliminate all extraneous factors.[7] Consider first a United States citizen who has worked during the entire past taxable year for a foreign corporation[8] in Venezuela where he has resided and has earned $50,000. The taxpayer is domiciled in a community property state.[9] He is married to a nonresident alien.[10]

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(1) Earned income exclusion—The exclusion from income under present law of $20,000 (or, in some cases, $25,000) for income earned abroad by U.S. citizens living or residing abroad is to be repealed.

6 P-H 1974 FED. TAXES ¶ 59,120.6.

However, it should be added that this consideration being given to § 911 by the Ways and Means Committee does not mark the first time this section has come under attack. In fact, § 911 has been subjected to repeated attack, but, save for the tax reform measures of 1962, has escaped relatively unscathed. Slowinski and Williams, *The Formative Years of the Foreign Source Earned Income Exclusion: Section 911*, 51 TAXES 355 (1973). In that work the authors recommend several reasons to support their argument that the earned income exclusion should be increased rather than decreased.

It should also be realized that even if § 911 were to be repealed, the controversy surrounding the *Bottome* decision would not immediately cease. Claims for refunds may be filed up to three years after filing of the return or up to two years after the date of payment of the tax, whichever is later. INT. REV. CODE OF 1954, § 6511(a). Thus, for some period of time after the repeal of § 911, refund claims would undoubtedly be filed.

7. This hypothetical will closely parallel the facts in *Bottome*, eliminating several elements which do not affect the subject of the inquiry.

8. It is not mandatory that the taxpayer be employed by a foreign corporation before he may claim the § 911 exclusion. Employment by a United States business in the foreign country is sufficient. Only that income "paid by the United States or any agency thereof" may not be excluded under § 911. INT. REV. CODE OF 1954, § 911(a).

9. It has long been recognized that, at least for purposes of income taxation, residence and domicile are not synonomous. Bowring v. Bowers, 24 F.2d 918 (2d Cir.), *cert. denied*, 277 U.S. 608 (1928); Rev. Rul. 56-269, 1956-1 CUM. BULL. 318. Although residence connotes some degree of permanency, it is something less than domicile, domicile being that place to which one has a "fixed or definite intention to return and remain." Niki v. United States, 28 Am. Fed. Tax R.2d 71-5135 (N.D. Cal. 1971), *aff'd*, 484 F.2d 95 (9th Cir. 1973).

Additionally, it should be recognized that the result would be the same if the United States citizen were domiciled, not in a community property state, but rather in a community property country if the rights of the spouses were substantially the same as those of spouses in states where the community property system has been held to divide the income between spouses. Rev. Rul. 65-37, 1965-1 CUM. BULL. 514.

10. The circumstances of the taxpayer being a United States citizen and being domiciled in a state do not necessarily alter the wife's status as a nonresident alien.

> The domicile of a husband in a community property State fixes the domicile of the wife in that State. However, the fact that the wife is domiciled in a community property State does not determine whether she is a nonresident alien.

At the conclusion of the taxable year the taxpayer files his return. Since his wife is a nonresident alien, he cannot file a joint return.[11] However, being domiciled in a community property jurisdiction, he is entitled to the benefits of income-splitting.[12] He thus files his separate return reporting one-half of the income or $25,000. The remaining $25,000 is his wife's share of the community income, but she is not required to pay tax on this portion.[13]

The final step is the exclusion from gross income allowed by section 911. The Regulations are clear that in this factual situation the taxpayer must halve the exemption and is thus entitled to exclude only $10,000 from his $25,000 portion of the income.[14] However, Example (5) of the relevant section of the Regulations was held invalid by the Tax Court in *Bottome*,[15] and the taxpayer was allowed to take the entire statutory exclusion.

The inequity engendered by the decision of the Tax Court can best be demonstrated by comparing the taxpayer of the hypothetical to one in the same position save for the fact that he is domiciled in a non-community property state. This latter taxpayer expects to pay tax on twice the amount of income as the former because he is not entitled to the benefits of income-splitting and cannot file a joint return with his nonresident alien wife. He excludes the full amount allowed by section 911, that is $20,000, and finds himself left with $30,000 income. The taxpayer from the community property state has also been granted the entire section 911 exclusion, though, and finds himself paying tax, not on $15,000, but on only $5,000.

The unfair advantage enjoyed by the taxpayer from the community property jurisdiction as a result of *Bottome* becomes ob-

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Rev. Rul. 56-269, 1956-1 CUM. BULL. 318, 318. *See also* Rev. Rul. 72-546, 1972-2 CUM. BULL. 435, *superseding*, I.T. 3859, 1947-2 CUM. BULL. 98.

11. INT. REV. CODE OF 1954, § 6013(a).

12. Poe v. Seaborn, 282 U.S. 101 (1930).

13. In the case of a nonresident alien, gross income includes only that income "derived from sources within the United States" and that income "effectively connected with the conduct of a trade or business within the United States." INT. REV. CODE OF 1954, § 872(a). The hypothetical wife's share of income is not "derived from sources within the United States", as it was earned through the performance of personal services in Venezuela. *See* Treas. Reg. § 1.862-1(a)(3) (1957).

14. Treas. Reg. § 1.911-2(d)(4)(ii) Example (5) (1963).

15. 58 T.C. at 217.

vious. The Tax Court in rendering its decision recognized this factor in observing: "True this gives a taxpayer in petitioner's position an advantage not enjoyed by residents of non-community-property States . . . ."[16] However, the Court then added, "but we find nothing in the law which denies that advantage."[17] It is submitted that there is, in fact, much "in the law" which denies that advantage.

Oversolicitude for the Letter and Lack of Consideration of the Purpose

A reading of the *Bottome* decision brings to light the shortcomings of the majority in that case. The "over solicitude for the letter"[18] is readily apparent. The court segregated what it considered key portions of section 911(c)(3)[19] along with selected excerpts from the committee reports[20] to arrive at its conclusion that ". . . Example (5) of section 1.911-2(d)(4)(ii), Income Tax Regs., which would cut in half the statutory exclusion . . . is not consonant with the statutory language and hence is invalid."[21]

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16. *Id.*
17. *Id.*
18. Federal Deposit Ins. Corp. v. Tremaine, 133 F.2d 827, 830 (2d Cir 1943).
19. 58 T.C. at 215 n.2. The key portion of the statute italicized by the court reads:

> [W]ith respect to amounts received for services performed . . . which are community income . . . the aggregate amount excludable under subsection (a) from the gross income of such husband and wife shall equal the amount which would be excludable if such amounts did not constitute such community income.

20. 58 T.C. at 215-16. One item which the court deemed of significance was a statement made in the reports of the committees of both Houses of Congress and included in the Regulations: "[T]he amount excludable under [section 911] from the gross income . . . shall be neither increased nor decreased by operation of community property law." Treas. Reg. § 1.911-2(d)(4)(i) (1963); H.R. Rep. No. 1447, 87th Cong., 2d Sess. A-86 (1962); S. Rep. No. 1881, 87th Cong., 2d sess. 233-34 (1962).

A second statement from the House Ways and Means Committee and the Senate Finance Committee which the majority asserted compelled them to find Example (5) invalid advised:

> [O]ne $20,000 . . . ceiling will apply with respect to the husband's earnings abroad even though under community property law, half of this income is the income of the wife.

H.R. Rep. No. 1447, 87th Cong., 2d Sess. 54, 55 (1962); S. Rep. No. 1881, 87th Cong., 2d Sess. 74, 76 (1962). However, when read in the context of case law developments at that same time, it is readily apparent that the committees were saying one celing, as opposed to two ceilings, would apply even though half the income was that of the wife. *See* Jean Renoi, 37 T.C. 1180 (1962), *aff'd*, 321 F.2d 605 (9th Cir. 1963) (both husband and wife unsuccessfully contended that each was entitled to exclude $20,000 of their portion of the community income earned by the husband in France). Thus, this portion of the committee reports furnishes no support for the holding that the statutory exclusion is not to be cut in half.
21. 58 T.C. at 217-18.

When considered divorced from case law developments at the time section 911(c)(3) was enacted and divorced from consideration of the purposes of Congress in enacting section 911 and subsection 911(c)(3), some of the language relied upon by the majority in *Bottome* would seem to indicate that the statutory exclusion cannot be halved in a factual situation such as the stated hypothetical. However, recognition should be given to the truism that "the expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history would often defeat the object intended to be accomplished."[22]

The problem is, in essence, one of statutory interpretation, and the alternatives are to interpret the words of the statute literally or to inquire into the history and purposes of the statute and thereby to effectuate the intent of Congress. An instructive lesson on statutory interpretation was expounded by the Supreme Court in *Ozawa v. United States*:[23]

> It is the duty of this court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance; but if this leads to an unreasonable result, plainly at variance with the policy of the legislation as a whole we must examine the matter further. We may then look to the reason of the enactment, and inquire into its antecedent history, and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail.[24]

Design and Purpose of Section 911

Section 911 has led a tumultuous existence since the time of its conception in 1926.[25] However, the exclusion provision has withstood repeated attacks, and legislators have often cited the salutory purposes which support the exclusion.[26] An analysis of the purposes which supported the original enactment of the forerunner to section 911 and which have supported its repeated reenactment

22. Helvering v. New York Trust Co., 292 U.S. 455, 464 (1934).
23. 260 U.S. 178 (1922). *See also* United States v. American Trucking Assn., 310 U.S. 534 (1940).
24. 260 U.S. at 194.
25. The legislative history of section 911 is set out in Slowinski & Williams, *The Formative Years of the Foreign Source Earned Income Exclusion: Section 911*, 51 TAXES 355 (1973).
26. *See, e.g.*, Krichbaum v. United States, 138 F. Supp. 515 (E.D. Tenn. 1956).

should prove elucidating in interpreting the statute as it would govern the hypothetical fact situation.

The remote ancestor of section 911 was enacted in 1926 for the purposes of putting "Americans who work abroad in a position of equality with their competitors by leaving them subject only to the income tax levied on them by the country where they were employed"[27] and of encouraging American citizens to go abroad.[28] That it was the clear intent of Congress that the provision not be applied so as to enable persons to escape all income tax became manifestly apparent when the exclusion was claimed by American military and diplomatic personnel stationed in foreign countries, who were not taxed by the country in which they were stationed.[29] When that situation was brought to light in the 1932 hearings on the predecessor to section 911, Senator Reed cogently observed: "These people do not deserve the exemption because they are not subject to the income taxation of the foreign countries in which they are stationed . . . ."[30] Senator Reed's subsequent proposal to amend the section so as to exclude from its operation amounts paid by the United States or an agency thereof was adopted.[31]

Thus, it is apparent that a primary purpose of the foreign-earned income exclusion was to preclude double taxation of Americans abroad.[32] Undoubtedly, if there is in fact no double taxation, the purposes and goals of the section could best be carried out by disallowing the exclusion.[33] In the hypothetical fact situation, and in *Bottome*, there is no taxation by the United States on one-half of the community income, the one-half allotted to the nonresident alien wife.[34] Thus, to give effect to the legislative purpose, the exclusion should be disallowed to the extent of one-half of its allowable limit. To the extent that a proportionate part of the income

27. Commissioner v. Wolfe, 361 F.2d 62, 66 (D.C. Cir.), *cert. denied*, 385 U.S. 838 (1966).

28. S. REP. No. 781, 82d Cong., 1st Sess. 52-53 (1951).

29. Prior to 1932 the section contained no provision excluding from its operation amounts paid by the United States or an agency thereof. REV. ACT. OF 1926, § 213(b)(14), *reenacted*, REV. ACT OF 1928, § 116(a).

30. 75 CONG. REC. 10,410 (1932) (remarks of Senator Reed).

31. REV. ACT OF 1932, § 116(a).

32. This rationale supporting the § 911 foreign-earned income exclusion is now of limited viability given the effect of the foreign tax credit provision of Internal Revenue Code § 901.

33. *See, e.g.*, Commissioner v. Wolfe, 361 F.2d 62 (D.C. Cir. 1966) (taxpayer employed in Iran and paid by U.S. Bureau of Public Roads from funds supplied by Iranian government; while technically the income came from Iran, the court held the taxpayer was not entitled to the § 911 exclusion citing as one of the principal reasons for its decision that the taxpayer was not required to pay tax to Iran on the income).

34. INT. REV. CODE OF 1954, § 872(a).

would be taxed twice, that same proportionate part of the section 911 exclusion should be allowed.[35]

Design and Purpose of Subsection 911(c)(3)

Subsection (c)(3) was not added to section 911 until the enactment of the tax reform measures of 1962.[36] Prior to that time there was no provision of section 911 expressly dealing with community income. The inquiry then must be made into the purposes for which Congress added the community income provision. The reports of the Ways and Means Committee[37] and of the Finance Committee[38] and the records of the floor debates[39] concerning the Revenue Act of 1962 furnish surprisingly little insight into why the Congress added subsection (c)(3) to section 911. It then becomes necessary to inquire into the principles and circumstances which prompted the Congress to add this provision to section 911 and thereby to determine the intent of Congress in its application.

"A cardinal principle of Congress in its tax scheme is uniformity . . . ."[40] Primarily since 1948[41] this principle has consistently im-

35. Although the literal wording of the section provides for no such apportioning of the exclusion, it would seem that effectuation of the purposes of § 911 mandates such an interpretation. Thus, where the objective of the statute is to prevent the double taxation of income but, at the same time, to ensure that the income does not escape taxation totally, which, in effect, it does when it is taxed by only one sovereign and allowed to be utilized as an exclusion by another sovereign, the exclusion should only be allowed ratably with the amount of income taxed twice. The regulations, in effect, applied § 911 in this manner when they stated that a taxpayer, only one-half of whose income was taxable by the United States, was entitled to only one-half of the statutory exclusion. Treas. Reg. § 1.911-2(d)(4)(ii) Example (5) (1963).

36. Rev. Act of Oct. 16, 1962, Pub. L. No. 87-834, § 11(a), 76 Stat. 1003, *amending* INT. REV. CODE OF 1954, § 911 (codified in INT. REV. CODE OF 1954, § 911(c)(3)).

37. H.R. REP. No. 1447, 87th Cong., 2d Sess. 54 (1962).

38. S. REP. No. 1881, 87th Cong., 2d Sess. 74 (1962).

39. 108 CONG. REC. 5303-46, 5376-435, 17529-30, 17544-51, 17556, 17586, 17737-39, 17740-99, 17811-13, 17836-71, 17882-90, 17890-91, 17892-914, 18063-81, 18087-90, 18090-99, 18100-27, 18151-54, 18155-69, 18171-99, 18199-201, 18205-35, 18315-26, 18382-89, 18435, 18445-46, 18447-82, 18482-83, 18484-99, 18504-05, 18513-14, 18527-642, 18709-10, 18716-26, 18732, 18734-43 (1962).

40. United States v. Gilbert Associates, Inc., 345 U.S. 361, 364 (1953).

41. The REVENUE ACT OF 1948 was enacted in that year providing for the so-called "split-income" plan permitted a married couple to file a joint return and pay twice the tax that would be paid by a single taxpayer having one-half of their joint income. This provision essentially gave to non-com-

pelled Congress to attempt to achieve uniformity of treatment of taxpayers in community property states and non-community property states. It can thus be fairly assumed that Congress adopted subsection 911(c)(3) with this principle of uniformity in mind and for the unstated purpose of ensuring equality of treatment between taxpayers of community property jurisdictions and non-community property jurisdictions.

It appears from a reading of the technical explanations of subsection 911(c)(3) in the committee reports that Congress, in its desire to ensure uniformity, was concerned with two basic situations: one in which the amount of the exclusion might be increased by the operation of community property laws, and the other in which the amount of the exclusion might be decreased by the operation of community property laws.[42] Regrettably, it is impossible to divine precisely the fact situations which were contemplated by the lawmakers. However, an analysis of case developments at about the time of the enactment of section 911(c)(3) should furnish some insight into what was weighing on the minds of the legislators when they decided to add the community income provision.

At about the time of the consideration of the amendatory provision to section 911, the case of *Jean Renoir*[43] was being considered by the Tax Court. In that case the taxpayer claimed that he and his wife were each entitled to the $20,000 section 911 exclusion from their respective portions of the community income earned by him, thus giving the community a total $40,000 section 911 exclusion. However, the court rejected the taxpayer's claim and allowed only one $20,000 exclusion. It is extremely plausible that the *Renoir*-type claim was that contemplated by Congress when it explained that the section 911 exclusion was not to be increased by the operation of community property laws.[44]

Similarly, there was a question prior to the addition of subsection (c)(3) of whether the wife's share of community income retained its exempt character when she had not resided in the foreign country with her husband.[45] Although there was authority[46] for the

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munity property taxpayers the same advantages previously enjoyed only by community property taxpayers.

42. "Paragraph (3) of section 911(c) provides in effect that . . . the amount excludable under section 911(a) is to be neither increased nor decreased solely by operation of community property law." H.R. REP. No. 1447, 87th Cong., 2d Sess. A-86 (1962); S. REP. No. 1881, 87th Cong., 2d Sess. 233-34 (1962).

43. 37 T.C. 1180 (1962), *aff'd*, 321 F.2d 605 (9th Cir. 1963).

44. In *Fink v. United States*, 454 F.2d 1387, 1392 n.4 (Ct. Cl.), *cert. denied*, 409 U.S. 844 (1972), the court recognized that the result reached in *Renoir* is now mandated by § 911(c)(3).

45. Of course, this question would never arise as long as the foreign-em-

proposition that exempt community income earned by the husband retained that character in the hands of the wife, two decisions[47] in the 1950's and a subsequent Revenue Ruling[48] dealing with section 251 of the 1939 Code[49] somewhat muddied the waters in this respect. The result of those authorities was that a spouse was entitled to the section 931 (formerly section 251) exclusion only if she individually met the requirements of that section. It would then seem that in order to preclude any possibility of a court's holding that because a wife did not satisfy the statutory residence requirements of section 911, her portion of the community income could not benefit from the exclusion, the Congress explained that subsection (c)(3) would function so that the section 911 exclusion would not be decreased by the operation of the community property laws.

Thus, in these two factual circumstances, which were undoubtedly in the contemplation of the legislators, subsection 911(c)(3) precludes, in one case, an increase of the statutory exclusion which would give community property taxpayers an unfair advantage over those domiciled in non-community property states and, in the second case, a decrease in the statutory exclusion which would give non-community property taxpayers an unfair advantage over community property taxpayers. Applying the interpretation of the committee with respect to subsection 911(c)(3) in the circumstances discussed[51] yields the uniformity of treatment which Congress intended. However, literally applying the interpretation from the committee reports in the *Bottome*-type situation, as the court did, yields an inequitable result which gives a community property taxpayer an unfair advantage.

The holding in *Bottome* then reflects a failure of the court to give adequate consideration to the Congressional principle of uni-

ployed community property husband earned more than twice the statutory exclusion. In those cases, even after the income was split with the wife residing in the United States, the husband still recognized enough income to allow him to utilize the entire statutory exclusion.

46. E.R. Kaufman, 9 B.T.A. 1180 (1928), acq., VII-2 CUM. BULL. 21 (1928).

47. Francis C. Mullen, 14 T.C. 1179 (1950) and Markham v. United States, 45 Am. Fed. Tax R. 1143 (S.D. Cal. 1953).

48. Rev. Rul. 54-16, 1954-1 CUM. BULL. 157.

49. INT. REV. CODE OF 1939, ch. 289, § 251, 52 Stat. 532 (now INT. REV. CODE OF 1954, § 931).

50. *Supra* note 41.

51. *See* text accompanying notes 42-48 *supra*.

formity of tax treatment. Courts in general are noticeably aware of this principle and seek to apply taxation statutes so as to deny any unfair advantage to taxpayers domiciled in community property jurisdictions:

> [I]n general, a common thread runs through these decisions [dealing with community income], namely, an effort by the courts to interpret the various statutory provisions in such manner as to produce uniformity of treatment of spouses throughout the country, whether they reside in community property States or elsewhere.[52]

Cases abound wherein taxation statutes have been interpreted so as not to give to domiciliaries of community property states preferential treatment over domiciliaries of non-community property states and vice-versa.[53]

In holding as it did, the Tax Court has attributed to Congress an intent to grant an advantage to community property taxpayers. However, it has been held: "A desire for equality among taxpayers is to be attributed to Congress, rather than the reverse,"[54] and, moreover, "[I]n the absence of a *'clear-cut statutory mandate'* an intention should not be attributed to Congress to grant preferential treatment to taxpayers who live in community property states."[55] Considering the legislative history and purposes of subsection 911(c)(3), it is impossible to discover any "clear-cut statutory mandate" of discrimination between taxpayers in that provision.

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52. Daniel M. Ebberts, 51 T.C. 49, 53 (1968).

53. *See, e.g.*, Epley v. Commissioner, 183 F.2d 1020 (5th Cir. 1950), *rev'g*, 13 T.C. 77 (1949) (holding a spouse's one-half of her military husband's income to be "earned income" so as to entitle that portion of the income to the benefits of the Current Tax Payment Act of 1943, the court stressing that the statute was not "drawn to . . . discriminate between soldiers from community and from non-community states"); Pierce v. United States, 254 F.2d 885 (9th Cir. 1958) (interpreting a spouse's one-half of her husband's business income to be business income so as to require that current business losses be applied against it rather than allowing them to be carried back to previous years; the holding achieved uniformity of treatment of taxpayers in community property and non-community property states); Ross v. Commissioner, 37 T.C. 445 (1961) (holding that taxpayers in community property jurisdictions were not entitled to an additional deduction of $2,000 in capital losses over capital gains, but were limited to $1,000 just as taxpayers in non-community property jurisidictions); Fink v. United States, 454 F.2d 1387 (Ct. Cl. 1972) (denying the section 911 exclusion to the spouse of a taxpayer who was domiciled in Washington and working in Japan for the United States, noting:

> Plaintiff's position in the instant case calls for an interpretation of Section 911 that discriminates in favor of spouses from community property states. Since there is no "clear-cut statutory mandate" for such preferential treatment, another important ground exists for holding against plaintiffs.)

54. Colgate-Palmolive-Peet Co. v. United States, 320 U.S. 422, 425 (1943).

55. Renoir v. Commissioner, 321 F.2d 605, 607 (9th Cir. 1963), *aff'g*, 37 T.C. 1180 (1962) (emphasis added).

INVALIDATION OF A REGULATION

One of the more disturbing aspects of the Tax Court's decision in *Bottome* is that in its holding it was required to invalidate a portion of the Treasury Regulations which was determinative of the issue there presented. Example (5) of section 1.911-2(d)(4)(ii) of the Regulations[56] expressly provides that in a situation such as the *Bottome* case and the introductory hypothetical, the taxpayer is allowed only one-half of the statutory exclusion: "The division of income . . . also divides the exemption provided under . . . this section." Upon reaching a result in *Bottome* which was contrary to this Example, the court held: "[W]e think Example (5) of section 1.911-2(d)(4)(ii), Income Tax Regs. . . . is not consonant with the statutory language and hence is invalid."[57]

That Treasury Regulations are to be accorded great weight by the courts has been frequently reiterated. Recently the Supreme Court has cautioned:

> [I]t is fundamental . . . that as 'contemporaneous constructions by those charged with administration of' the Code, the Regulations 'must be sustained unless *unreasonable and plainly inconsistent with the revenue statutes*' and 'should not be overruled except for weighty reasons.'[58]

The Supreme Court has thus set out a two-pronged standard to be considered in overruling Regulations—the Regulation must be both (1) "unreasonable" and (2) "plainly inconsistent with the revenue statutes."

The rationale for the courts' insistence that Treasury Regulations are not to be lightly invalidated has been variously stated. Principal reliance is derived from section 7805(a) of the Code[59] which provides, in pertinent part, that "the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title . . . ." Since they are promulgated under such statutory authority, the Regulations are then said to "have the force and ef-

56. Treas. Reg. § 1.911-2(d)(4)(ii) (Example (5) (1963).
57. 58 T.C. at 217-18.
58. Bingler v. Johnson, 394 U.S. 741, 749-50 (1969) (emphasis added). *See also* Fawcus Machine Co. v. United States, 282 U.S. 375, 378 (1931); Boske v. Comingore, 177 U.S. 459, 470 (1900); Commissioner v. South Texas Lumber Co., 333 U.S. 496, 501 (1948); Brewster v. Gage, 280 U.S. 327, 336 (1930); Norwegian Nitrogen Products Co. v. United States, 288 U.S. 294, 315 (1933).
59. INT. REV. CODE OF 1954, § 7805(a).

fect of law."[60] Having such force they are not to be lightly discarded by the courts.

There has also been a noticeable deference to the Regulations on the basis of their being promulgated by the office charged with the responsibility of effectively administering the tax laws of the nation. The United States Supreme Court, in this regard, has noted that interpretations by administrative bodies are entitled to great weight where the interpretation involves "contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new."[61] This respect for the tax-administering bodies has even impelled the Supreme Court to remark that courts should refrain, insofar as possible, from mandating changes in the administration of the tax laws:

> [W]e do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, *"it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments."*[62]

Thus, it can be seen that, for a variety of reasons, Treasury Regulations are to be accorded great weight. Because of the respect which is to be accorded to them, respect approaching that to be accorded to statutes, they are not to be invalidated except for "weighty reasons" and upon a showing of unreasonableness and inconsistency.[63]

That the Regulation held invalid in *Bottome* is not unreasonable but rather is unquestionably an intelligent, equitable and reasonable construction of section 911(c)(3) is pointed out in the dissenting opinion of Judge Raum.[64] Example (5), by its operation, denies to taxpayers from community property states the unfair advantage of the full statutory exclusion when they are taxed on only one-half of the earned income. In so doing, it prevents the inequitable situation which results from the *Bottome* decision. To argue that

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60. Industrial Life Ins. Co. v. United States, 344 F. Supp. 870, 875 (D.S.C. 1972), *aff'd*, 481 F.2d 609 (4th Cir. 1973), *cert. denied*, 414 U.S. 1143 (1974).
61. Norwegian Nitrogen Products Co. v. United States, 288 U.S. 294, 315 (1933).
62. United States v. Correll, 389 U.S. 299, 306-07 (1967) (emphasis added).
63. Bingler v. Johnson, 394 U.S. 741, 750 (1969).
64. 58 T.C. at 218. It should be noted that three judges of the Tax Court concurred in Judge Raum's dissent.

the Regulation is "unreasonable" would require a mind impervious to the realities of the situation.

The second prong of the Supreme Court's test would require a determination that the Regulation is "plainly inconsistent with the revenue statutes." The Tax Court placed emphatic reliance on its finding that the Regulation invalidated was at variance with the statutory language.[65] However, it at no time considered the Regulation in connection with the statutory purposes of section 911 and of subsection 911(c)(3). Undoubtedly, had the court recognized the underlying purpose of section 911 to prevent the double taxation of income and of subsection 911(c)(3) to treat community property and non-community property taxpayers in parity, it would have concluded that while the Regulation might not conform to the exact words of the statute, it most assuredly is plainly consistent with the purposes of the section. It is then readily apparent that the majority of the *Bottome* court failed to render to Treasury Regulation section 1.911-2(d)(4)(ii) Example (5) that degree of respect mandated by decisions of the Supreme Court of the United States.[66]

Strict Construction of Exemption Provision

During the past half century various rules have developed governing the interpretation of tax statutes. Perhaps the most well-known (and most often asserted) of these rules is that tax laws are in general to be construed most strongly against the government and in favor of the taxpayer.[67] However, contrary to the general rule, grants of exemptions are to be given strict interpretation against the taxpayer.[68]

It has been stated that the "basis for applying the rule of strict construction to statutory provisions granting tax exemptions . . . is to minimize differential treatment and foster impartiality, fair-

65. *Id.* at 217-18.
66. It should be realized, though, that even if the court were to interpret the phrase "plainly inconsistent with the revenue statutes" to mean "plainly inconsistent with the letter of the revenue statutes", it still could not hold the Regulation invalid. The Supreme Court test, being a mandatory two-part test, requires a determination of both inconsistency and unreasonableness.
67. Gould v. Gould, 245 U.S. 151, 153 (1917).
68. Commissioner v. Jacobson, 336 U.S. 28, 48-49 (1949).

ness, and equality of treatment among taxpayers."[69] Section 911, being an exemption section, should then be construed against the taxpayer claiming the exclusion so as to minimize any differential treatment among taxpayers. The decision in *Bottome* reflects a liberal construction of section 911 in favor of the taxpayer. The taxpayer, although he was required to recognize only one-half of his earned income, was given the benefit of the entire statutory exemption. By so holding, the court admittedly gave to "a taxpayer in [Bottome's] position an advantage not enjoyed by residents of non-community-property States . . . ,"[70] the precise inequity which the rule of statutory construction of exemptions against the taxpayer was designed to preclude.

The argument can be made that a taxpayer in Bottome's position is entitled to the exclusion, as, regardless of how the statute is construed, there is nothing in the letter of the law to deny the exclusion to him. However, the mere fact that a taxpayer's claim of exemption falls within the letter of the law is insufficient to entitle him to that exemption.

> Taxation is the rule and exemption therefrom the exception; and the claimant of such an exemption must show his right thereto by evidence which leaves the question free from doubt. The claimant is within the letter *as well as the spirit* of the law.[71]

As discussed previously,[72] the spirit and legislative purposes of section 911 and of subsection 911(c)(3) are in no way furthered by the allowance of the full exclusion to a taxpayer who recognizes only one-half of his income. The taxpayer's claim then cannot be said to fall within the "spirit" of the law, and it should have been disallowed.

Thus, had the Tax Court adhered to accepted principles of statutory construction, the court would have denied the benefit of the full section 911 exclusion to the taxpayer in *Bottome* and would have reached the Congressionally compelled result of fair, impartial and equal treatment of taxpayers from community property states and those from non-community property states. Its failure to adhere to those accepted principles has resulted in an anomolous hold-

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69. 3 C. SANDS, STATUTES AND STATUTORY CONSTRUCTION, A REVISION OF THE THIRD EDITION OF SUTHERLAND STATUTORY CONSTRUCTION § 66.09, at 207 (4th ed. 1974).

70. 58 T.C. at 217.

71. Jones v. Iowa State Tax Commission, 247 Iowa 530, 74 N.W.2d 563, 565 (1956) (emphasis added). *Accord*, Trustees of Iowa College v. Baillie, 236 Iowa 235, 17 N.W.2d 143 (1945); Craig v. Bates, 44 Misc. 2d 432, 254 N.Y.S.2d 244 (1954); Clarke v. Union Trust Co. of Dist. of Md., 192 Md. 127, 63 A.2d 635 (1949);

72. *See* text accompanying note 30 *supra*.

ing, in essence, that Congress had mandated inequitable treatment of taxpayers.[73]

CONCLUSION

The decision of the Tax Court in *Robert R. Bottome* has resulted in a situation of a taxpayer domiciled in a community property state having an inequitable advantage over one similarly situated but from a non-community property state. The court based its decision on a determination that there was nothing in the letter of the statute to deny to the taxpayer the benefits of the full exclusion. However, assuming arguendo that on its face the statute does not deny the benefit of the full exclusion, the inquiry should not have ceased at that point.

Consideration of the legislative purposes supporting the enactment of section 911 and of subsection 911(c)(3) would have mandated a denial of the full exclusion to the taxpayer in *Bottome* and, thus, equitable treatment of taxpayers domiciled in community property and non-community property jurisdictions. Additionally, had the court given to the portion of the Regulations[74] which it invalidated the weight and respect to be accorded to such promulgations and evaluated that Regulation in terms of its reasonableness and consistency with the statute, the Regulation would undoubtedly have been upheld as a proper interpretation of Congressional intent. Finally, commonly accepted rules of statutory construction, if applied by the court, would have required a strict interpretation of section 911 against the taxpayer and would have yielded an equitable result.

It is hoped that future courts faced with a claim for the section 911 exclusion in the context of a situation such as that of *Robert R. Bottome* will not yield to the taxpayer on the basis of the *Bot-*

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73. *Cf.* Bingler v Johnson, 394 U.S. 741, 751-52 (1969) (taxpayer unsuccessfully contended that all amounts received by him while on leave to write his dissertation were excludable from gross income as "scholarships" under § 117 of the Internal Revenue Code; court noted that exemptions are to be construed narrowly and, in view of the fact that under § 117 even modest sums received by teaching assistants were not exempted, declined "to assume that Congress intended to sanction—indeed . . . to compel—such an inequitable situation").

74. Treas. Reg. § 1.911-2(d)(4)(ii) Example (5) (1963).

tome decision.[75] The arguments not treated by the majority in that case should be fully aired without that "over solicitude for the letter" which unfortunately prevailed in the Tax Court.

ROBERT G. RUSSELL, JR.

75. On March 15, 1974, suit was filed in the District Court for the Southern District of California after a claim for refund by a taxpayer in the same circumstance of Robert Bottome was disallowed. Russell T. Emery, Civil No. 74-226-T (S.D. Cal., filed Mar. 15, 1974).