Internal Revenue Service

memorandum

CC:INTL-0196-95
Br6:RLorence

date: FEB 2 1996

to: Sharese Stevens, Manager Group 2111
Office of the Assistant Commissioner (International)

from: Senior Technical Reviewer, Branch 6
Office of Associate Chief Counsel (International)

subject: [redacted]

This responds to your February 1, 1995, request for technical assistance. The issue is the source of compensation earned by a U.S. citizen living and working in Belgium for the taxable year [redacted] Specifically, you have asked us whether the taxpayer's compensation should be resourced under Article 23 (Double Taxation) of the U.S. -Belgian income tax treaty (the "Treaty"). Preliminarily, we note that the taxpayer should not receive a foreign tax credit with respect to amounts that he excluded under the foreign earned income credit of section 911. Section 1.911-6(a).

The taxpayer was considered to be a resident for Belgian domestic tax purposes in [redacted] and taxed by Belgium on his worldwide income. As a U.S. citizen, the taxpayer was also subject to United States tax on his worldwide income. The taxpayer claims that most of his income is foreign source income under Article 23(2) of the Treaty for purposes of determining his foreign tax credit.

Article 23(2) provides that, subject to the provisions of U.S. law applicable to the taxable year, the United States will allow a U.S. citizen or resident to credit against his U.S. tax the appropriate amount of Belgian tax. The appropriate amount of Belgium tax is based on the tax paid to Belgium but can not exceed the amount of U.S. tax attributable to income from Belgian sources. The Taxpayer argues that most of his compensation is foreign source for purposes of the U.S. foreign tax credit because he is subject to Belgian tax on his worldwide income. The Treaty provides, however, that income described in Articles 6 through 21 is foreign source only if the income is taxed by Belgium in accordance with Articles 6 through 21 of the Treaty.

Article 23(1) of the Treaty, which provides that the United States may tax its citizens as if the Treaty had not come into effect, does not apply to the foreign tax credit provisions of Article 23(2) of the Treaty. Art. 23(1)(a) of the Treaty.

For [redacted], most of the taxpayer's $[redacted] was earned as compensation for the performance of dependent personal services. This amount included a $[redacted] fringe benefit for use of an automobile and $[redacted] of U.S. wage withholding. Belgium does not tax the amount of wages withheld in the U.S. The taxpayer worked 222 days in Belgium and 18 days in the United States in [redacted]. Article 15(1) of the Treaty provides that compensation derived by an individual from labor or personal services performed as an employee may be taxed in the Contracting State where he is resident. Article 15(2) provides that such income derived from labor or personal services performed in the other Contracting State may also be taxed in that Contracting State.

The first step in determining the U.S. and Belgium's right to tax the taxpayer's compensation is to determine his residency under Article 4 of the Treaty. Article 4 provides that a person is a resident of the United States or Belgium if he is a resident for purposes of U.S. or Belgian tax. Solely for the purpose of interpreting whether the taxpayer is a U.S. resident under Article 4, the residency of a U.S. citizen is not determined under section 7701(b), but under section 1.871-2(b) of the regulations. That regulation determines residency by an individual's intentions with regard to the nature and length of his stay in a country. If you determine, after applying that rule, that the taxpayer is a resident of both countries, then you must apply the tie-breaker rules of Article 4(2) of the Treaty. We cannot determine, based on the limited facts available to us, whether the taxpayer is a resident of the United States or Belgium.

If the taxpayer was a U.S. resident under the Treaty, Belgium could tax the taxpayer's compensation in the amount of $[redacted] ($[redacted] less $[redacted] in U.S. wage withholding) only to the extent it was derived by the performance of services in Belgium. Art. 15(1) of the Treaty. The taxpayer did not perform all his personal services in Belgium: 18 of his working days were spent in the United States. Because the Treaty does not provide a method for allocating income between the United States and Belgium, the compensation, including the fringe benefit for the car, should be allocated between the United States and Belgium according to the number of days worked in each country. Art. 3(2) of the Treaty and section 1.861-4(b) of the regulations. The amount of compensation allocated to Belgian sources is taxable by Belgium under Article 15(2), and would be foreign source income for purposes of the U.S. foreign tax credit under Article 23(2).

If the taxpayer was a resident of Belgium under the Treaty, Belgium would have the right to tax all of his personal service income under Article 15(1). Article 23(3)(a) provides that if a resident of Belgium derives income that has been taxed by the

United States under Articles 6 through 21, the income will be exempt from tax in Belgium. As a Belgian resident, the taxpayer's income allocable to his 18 days working in the United States would be taxable by the United States under Article 15(1) and therefore exempt from Belgian tax under Article 23(3)(a).[1] Article 23(2) provides that the United States will treat income taxed by Belgium under Articles 6 through 21 as foreign source income for purposes of its U.S. foreign tax credit. As noted previously Belgium did not tax $[redacted] in U.S. wage withholding, and apparently taxed only a small portion of the automobile fringe benefit totaling $[redacted]. To the extent those amounts were not taxed by Belgium, they should not be foreign source income under Article 23(2). In addition, because Belgium would give up taxing jurisdiction on the income allocable to the 18 working days in the U.S. under Article 15, the amount of compensation allocated to those days should not be treated as foreign source income for purposes of the U.S. foreign tax credit.

Our examination of the taxpayer's return also shows that he allocated a part of his pension distribution from the Department of State between U.S. and foreign sources. See "Supplement to Form 116 - Sources of Income." It is not clear from the return why the taxpayer treated a portion of the pension distribution as foreign source. For example, it could have been contributions made to the pension plan from the performance of services abroad. We note, however, that the Treaty does not support this allocation. Article 19(1) of the Treaty provides that pension income paid by the United States from public funds for labor or personal services performed in the discharge of government functions to a U.S. citizen is exempt from Belgium tax. Because the taxpayer is a U.S. citizen and received a U.S. government pension, this income is not taxable by Belgium under Article 19(1). Therefore, it cannot be treated as foreign source income for purposes of the U.S. foreign tax credit under Article 23(2).

We hope this information provides the assistance that you requested. If you have any questions or need additional information, please contact Bob Lorence at 622-3880.

Philip L. Garlett

Philip L. Garlett

[1] We assume, as you and the taxpayer's representative appear to have, that the 183 day exception of Article 15(2) does not apply.