



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR Chief, Appeals Office,
Boise, Idaho

C:RM:AP:BOI

FROM: W. EDWARD WILLIAMS
Senior Technical Reviewer, Branch 1 CC:INTL:Br1

SUBJECT:

This Field Service Advice responds to your memorandum dated August 25, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND:

Taxpayer =
X =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
w =

ISSUE(S):

- Whether income derived from rendering personal services by taxpayer ("Taxpayer") as an employee of X Corporation on Johnston Island during Year 4 may be excluded by the Taxpayer from her gross income under section 931(a) of the Internal Revenue Code of 1986 ("I.R.C.") ?

2. Alternatively, whether the taxpayer can qualify for the I.R.C. § 911 “foreign earned income exclusion” on the basis that Johnston Island is a “foreign country” under I.R.C. § 911(b)(1)(A)?

CONCLUSION:

Based on the facts presented, we conclude that the Taxpayer is not entitled to claim the I.R.C. § 931 exclusion, because Johnston Island is not a “specified possession” as defined in I.R.C. § 931(c).

We also conclude that the Taxpayer is not entitled to claim the I.R.C. § 911 foreign earned income exclusion because Johnston Island is not a “foreign country” as defined in I.R.C. § 911(b)(1)(A) and Treas Reg. § 1.911-2(g) and (h).

FACTS

Taxpayer is an individual U.S. citizen who was employed during Years 1 through 4 by X Corporation, a civilian contractor performing U.S. government contracts on Johnston Island. The Taxpayer earned total gross wages of \$w during Year 4 while employed on Johnston Island. There is no information provided regarding the amount of taxpayer’s income earned, or location of employment during Years 1 through 3. Taxpayer originally filed her income tax return (Form 1040) for Year 4, not claiming the I.R.C. § 931 exclusion and including in gross income all wages she earned while working on Johnston Island. She subsequently filed an amended return (Form 1040X), making a claim for refund of federal income taxes paid for Year 4 on the basis that she is entitled to the benefits of the I.R.C. § 931 exclusion.

Johnston Island is a 625 acre island, and it is the largest of several islands constituting the island group known as the “Johnston Atoll”, located approximately 700 nautical miles southwest of Hawaii. Johnston Island is an unincorporated territory of the United States. It was designated as a Naval Defensive Sea Area and Airspace reservation on February 14, 1941 by Executive Order 8682. It is currently operated and maintained by Field Command, Defense Special Weapons Agency (DAWA), Kirkland Air Force Base, New Mexico. In the early 1970s, the military began moving chemical weapons from Okinawa to Johnston Island, and the island became a major storage facility for U.S. chemical weapons.

In the late 1980s, the U.S. Defense Department began construction of an incinerator facility to destroy the chemical weapons on the island. Testing of the facility began in 1990, with full-scale operations beginning in 1993. Taxpayer was employed by Corporation X in conjunction with the operation of the facility during Year 4. Years 1 through 4 are all calendar years subsequent to 1990.

LAW AND ANALYSIS:

I.R.C. § 931 provides in pertinent part as follows:

(a) General rule.-In the case of an individual who is a bona fide resident of a specified possession during the entire taxable year, gross income shall not include -

(1) income derived from sources within any specified possession, and
 (2) income effectively connected with the conduct of a trade or business by such individual within any specified possession. ***

(c) Specified possession.-For purposes of this section, the term "specified possession" means Guam, American Samoa, and the Northern Mariana Islands.

I.R.C. § 931(a) states that the exclusion under that subsection is available only to "an individual who is a bona fide resident of a *specified possession*." [Emphasis added.] A "specified possession" is defined by I.R.C. § 931(c) as "Guam, American Samoa, and the Northern Mariana Islands." Thus, the I.R.C. § 931 exclusion may not be claimed by the taxpayer, because Johnston Island is not a "specified possession" within the meaning of the statute.

Prior to the Tax Reform Act of 1986 (Pub. L. 99-514 , which enacted the Internal Revenue Code of 1986 (hereinafter "1986 Code"), I.R.C. § 931(a) of the Internal Revenue Code of 1954 (hereinafter "1954 Code"), provided an exclusion from U.S. gross income, for certain income of U.S. citizens engaged in a trade or business in a U.S. possession if such income was "derived from sources within a possession of the United States." The exclusion for possession source income that was available under section 931 of the 1954 Code was limited to individuals who could show that 80 percent or more of their gross income was derived from a U.S. possession for the three-year period immediately preceding the taxable year, and that 50 percent or more of their gross income was derived from a trade or business in such U.S. possession. The taxpayer's claim for refund does not include information regarding Years 1 through 3, such as the amount of income earned or the location of her employment. This omission is somewhat academic because it is clear that the 1954 Code provisions do not apply to Years 1-4.

Section 931 of the 1954 Code did not define the term "U.S. possession." Treas. Reg. § 1.931-1, enacted under the 1954 Code, lists various possessions of the United States, including Johnston Island, that were considered to be "possessions of the United States " for purposes of section 931 of the 1954 Code. The Tax Reform Act of 1986 generally amended the provisions of prior section 931, including the addition of a definition of the term "specified possession" in

subsection (c). Since it is not included in this definition of “specified possession”, Johnston Island is no longer a possession for purposes of I.R.C. § 931, regardless of the regulation issued under the 1954 Code.

Thus, neither the regulation nor the prior Code section is applicable to the time period when the taxpayer worked for X Corporation on Johnston Island. The effective date provisions of the Tax Reform Act of 1986, (Section 1277 of Pub. L. 99-514.) indicate that the amended section 931, under the 1986 Code is to apply to taxable years beginning after December 31, 1986. Thus, taxpayer’s claim for refund for taxes should be denied on the basis that she is not entitled to claim the I.R.C. § 931 exclusion for Year 4.

It has been suggested as an alternative that taxpayer may argue that she is entitled to claim the “foreign earned income” exclusion under I.R.C. § 911 for Year 4, for the compensation she earned from performing personal services on Johnston Island. I.R.C. § 911(b)(1)(A) limits the availability of the foreign earned income exclusion to compensation earned while working in a “foreign country.” The term “foreign country” is defined in Treas. Reg. § 1.911-2(h) as “any territory under the sovereignty of a government other than that of the United States.” Treas Reg. § 1.911-2(g) provides that the term “United States when used in a geographical sense includes *** the possessions and territories of the United States.” Johnston Island is not a “foreign country” for purposes of I.R.C. § 911, because it is a possession of the United States. Thus, the statute will not support Taxpayer’s assertion that she is entitled to claim the “foreign earned income” exclusion under I.R.C. § 911, for income earned for personal services performed on Johnston Island.

If you have any further questions, please call (202) 622-3880.

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