DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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MEMORANDUM FOR David Morris, TSS and Michael Goodman, TLS Customer Service, AC (International)

FROM: Phyllis E. Marcus,
Chief
CC:INTL:Br.2

SUBJECT: Treatment of Members of the Armed Forces Assigned to the North Atlantic Treaty Organization under Section 911.

This technical assistance responds to your memorandum dated January 11, 1999, regarding the availability of the section 911 exclusion to members of the Armed Forces (service members) assigned to the North Atlantic Treaty Organization (NATO). Factual information that is the basis for this memorandum was submitted by Lt. Col. Thomas K. Emswiler, U.S. Army, Executive Director, Department of Defense, Armed Forces Tax Council (Tax Council). Technical assistance 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.

ISSUE:

Whether service members assigned to NATO are eligible to elect the section 911 exclusion.

CONCLUSION:

In applying the common law test articulated in Adair v. Commissioner, T.C. Memo. 1995-493, acq., 1996-1 C.B. 1, service members assigned to NATO are employees of the United States under section 911(b)(1)(B)(ii) and are ineligible to elect the section 911 exclusion for foreign earned income.

FACTS:

The United States has the sole authority to assign its service members to any position, including assignment to NATO. Service members assigned to NATO fill positions that are either dedicated to the United States or have not been allocated to a particular nation. Service members are not permitted to compete for open positions at NATO, and neither a member nor NATO can compel the assignment of a particular individual. Once the United States assigns a service member to NATO, that position becomes the service member's appointed place of duty. A service member serving NATO is performing duty related to the member's military service.

A service member is assigned to NATO pursuant to a written order from the United States advising the member of a permanent change of station (PCS), which orders the member to perform duty at NATO. All military transfers are initiated with a PCS order. The PCS specifies the start and end dates of the member's service at NATO. A service member does not have a separate contract with NATO and is not permitted to take a loyalty oath to NATO. A service member's duty is to "support and defend the Constitution of the United States" and that duty may not be subordinated.

The United States does not relinquish its right to control its service members assigned to NATO. The assigned member remains under the command of a United States Commander who exercises both administrative and judicial control over the member. For example, only the United States Commander (or another United States officer) can grant leave to the service member or take punitive action against the member. Only that Commander or (another United States officer) can initiate action to remove the member from the Armed Forces. At NATO, the service member may be supervised by a foreign military member, but that does not change the service member's paramount duty to the United States.

If a member is absent from his or her place of duty without authority, the member's United States Commander can initiate punitive action in accordance with the Uniform Code of Military Justice (UCMJ). NATO generally lacks the authority to take punitive action against a member; however, in limited circumstances and only after coordination with the United States, NATO may relieve a member from the NATO position. However, relief from a NATO position does not affect the member's status as a member of the Armed Forces. The member's Service (Army, Navy, Air Force or Marines) would order the member to a new place of duty, or if appropriate, initiate action required to terminate the member from the Armed Forces either administratively or through UCMJ action. Although the member's misconduct at NATO would be the basis of the termination, only the United States, not NATO, can discipline the member.

A service member is assigned to NATO by the United States and performs services at NATO as a member of the United States military. He represents the United States at NATO. He is under the command of a United States Commander

and is evaluated by the United States Commander. The United States continues to provide the member with all benefits, pays the member's salary and issues a Form W-2. Both the service member and the United States intend that the member's relationship with the United States continue. For example, a service member may not cash out any accrued leave when assigned to NATO. A service member is not allowed to take a loyalty oath to NATO. A service member at NATO does not abandon his duty to the United States. The United States is engaging in an integral part of the business of government by allowing members of the Armed Forces to serve at NATO. NATO has no authority to remove a member from the Armed Forces and very limited authority to remove a service member from a NATO position. The service member's relationship with NATO is temporary.

The information provided by the Tax Council does not specify how many service members are assigned to NATO or describe any specific positions a service member might fill at NATO. We assume that service members fill various positions at NATO.

DISCUSSION:

SECTION 911(a)(1)

At the election of a qualified individual, section 911(a)(1) provides a limited exclusion from gross income for foreign earned income. Section 911 provides that foreign earned income includes amounts received from sources within a foreign country as earned income for services performed, but does not include amounts "paid by the United States or an agency thereof to an employee of the United States or an agency thereof." Section 911(b)(1)(A) and (B)(ii).

The ADAIR OPINION

The issue in Adair was whether Mr. Adair, a civilian, who performed services for NATO as a transferee transferred and paid by the U.S. Army, was an employee of the United States or NATO for purposes of section 911. The Tax Court concluded that Mr. Adair was an employee of NATO; accordingly, he was entitled to the foreign income exclusion of section 911.

Mr. Adair was employed by the U.S. Department of the Army (DOA) as a program analyst in the Office of the Comptroller of the Department of Defense (DOD). He was appointed by the Secretary General of NATO to the post of senior statistician in 1986. By electing to be recruited by NATO on a "reimbursable" basis, Mr. Adair would receive his salary and emoluments directly from the DOA at the salary level applicable to his former grade as a U.S. employee.

When Mr. Adair transferred to NATO he was covered by the transfer provisions of the Federal Employees International Organization Service Act (FEIOSA), Pub. L. 85-795. Congress enacted FEIOSA in 1958 to encourage details and transfers to international organizations by Federal employees. FEIOSA defines a transfer as a change of position by an employee from an agency to an international organization. 5 U.S.C. § 3581(4). In general, an employee who transfers to an international organization retains coverage, rights and benefits in the various employee benefits offered to Federal employees, including health benefits and participation in the applicable retirement plan. A transferee may retain accumulated annual leave or elect to receive payment of such leave in a lump sum. Provided the transferee timely applies, the transferee has an absolute right to reemployment with the agency in his former or a similar position. Upon reemployment, the employee's sick leave account is reinstated.

Thus, Mr. Adair was entitled to and continued to participate in the U.S. Civil Service Retirement System, and in health and life insurance programs available to U.S. employees, and he was granted the right to be reemployed by the agency from which he was transferred following his tenure with NATO.

Mr. Adair acquired employment with NATO by applying for a position NATO advertised. When he commenced employment with NATO he was required to execute the following oath:

> I solemnly undertake to exercise in all loyalty, discretion and conscience the functions entrusted to me as a member of the staff of NATO, and to discharge these functions with the interests of NATO only in view. I undertake not to seek or accept instructions in regard to the performance of my duties from any government or from any authority other than the Organization.

Adair, T.C. Memo. 1995-493.

NATO required Mr. Adair to work full time and personally render his services. NATO authorities dictated the results that he was to accomplish, the means by which he was to attain those results, and it retained the right to control the order and sequence of the tasks that he performed. His performance was evaluated by a NATO supervisor. NATO personnel regulations established the details of employment concerning work hours, holidays and leave rights. NATO provided insurance coverage and Mr. Adair also received educational benefits.

Among the arguments rejected by the Tax Court in Adair was the Service's assertion that under the applicable treaties and agreement, Adair was a U.S. employee seconded to NATO, making it unnecessary to consider the facts and circumstances. The Service argued that the treaty framework created by the Agreement on the Status of the North Atlantic Treaty Organization (Ottawa

Agreement), 5 U.S.T. 1087, T.I.A.S. 2992, and the Agreement Concerning the Employment by the North Atlantic Treaty Organization of United States Nationals (London Agreement), 5 U.S.T. 1112, T.I.A.S. 2992, gave the United States the ability to tax the amounts it paid its U.S. citizens where it hired its citizens and assigned them to NATO's international staff. The Service further argued that in inserting the word "employee" in 1981, Congress only intended to carve out from the exception to the section 911 exclusion those persons who were their own employers, i.e., independent contractors, and did not intend to reach the "seconding" case of an individual employee of one employer (the United States) seconding to another employer (NATO). The Service argued that in the seconding case it was appropriate to adopt a special, broader definition of "employee" to effectuate the purposes of section 911 and the treaty structure created by Ottawa Agreement and the London Agreement.

The Tax Court concluded that section 911, as amended by Section 111(a) of the Economic Recovery Tax Act of 1981 (ERTA), Pub. L. 97-34, had modified the applicable treaties and agreements; hence the benefits of section 911 extend to individuals who receive compensation from the United States, but who are not employees of the United States. Thus, it found it necessary to decide whether the United States government or NATO was Mr. Adair's common law employer.

The court first analyzed the conditions of a transferee's employment at NATO. It concluded that the transfer process to NATO for a Federal employee was a joint endeavor between the United States and NATO, and agreed with the Service that NATO hirees could be accepted only with the consent and at the discretion of the head of the U.S. agency, as well as the Secretary General of NATO. Although the United States could deny a transferee's request to extend an agreed term, the court rejected the Service's contention that the United States could require a transferee's return or terminate the employment with NATO before expiration of the agreed upon term. Even if the United States denied the request to extend a term, a transferee could choose to stay beyond his agreed upon term and thereby forfeit reemployment rights. The court emphasized that NATO's rights to terminate employment were "markedly broader than the rights of the United States". Specifically, NATO could terminate Mr. Adair or any transferee not only upon the expiration of his term, but also due to disciplinary action, unsatisfactory performance, or if the country of which he was a national ceased to be a NATO member, withdrew, or failed to renew a security clearance. The court found Mr. Adair's receipt of employee benefits from the United States did not conclusively determine that he was an employee, but rather that someone believed he was eligible for the benefits.

The court also held it was unclear from the facts that the United States intended to continue its employment relationship with Mr. Adair. Rather, the court concluded that the United States sought to encourage transfers and to further encourage the reemployment of transferees upon the expiration of their terms. The

court noted that Congress enacted FEIOSA to encourage details and transfers to international organizations, and such transfers were encouraged by providing benefits and reemployment rights to transferees.

The Service also argued that even though Mr. Adair may be an employee of NATO under the common law test, he remained an employee of the United States for purposes of section 911 due to the benefits and rights he retained as a transferred employee. The court rejected this argument stating, "the determination of whether petitioner was an employee of the United States depends on all the facts and circumstances, including the paramount fact that NATO, rather than the United States, controlled the manner in which his work was performed." Adair citing Matthews v. Commissioner, 92 T.C. at 360. (Emphasis added.)

As a result of the Adair opinion, the Service issued an AOD stating that it would acquiesce in the Adair opinion and no longer take the position that a transferee to NATO who is paid by the United States transferring agency, but who is otherwise a common law employee of NATO, is necessarily barred from claiming the section 911 exclusion. Adair v. Commissioner, Action on Decision, 1996-002 (March 4, 1996).

THE COMMON LAW RULES DEFINING EMPLOYEE

Section 911 does not define the term “employees of the United States”. However, according to section 3121, “employee” is defined to include “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.” The legal test under the common law to determine whether an individual is an independent contractor or an employee is whether the alleged employer had the “right to control” the alleged employee, not whether the alleged employer actually exercised that right. Weber v. Commissioner, 103 T.C. 378 (1994), aff’d per curiam, 60 F.3d 1104 (4th Cir. 1995); Professional & Executive Leasing, Inc. v. Commissioner, 89 T.C. 232, aff’d, 862 F.2d 751 (9th Cir. 1988); McGuire v. United States, 349 F.2d 644 (9th Cir. 1965); James v. Commissioner, 25 T.C. 1296 (1956). Courts that have considered whether a worker is an employee under section 911 have applied the common law test. See, Adair v. Commissioner, T.C. Memo. 1995-493; Juliard v. Commissioner, T.C. Memo. 1991-230.

To determine the employment relationship between the parties, courts consider various factors to determine whether the alleged employer had the right to control the alleged employee. Courts have recently focused on the following factors to examine the relationship between the parties:

1. the right to control the manner in which the work is performed;
2. whether the individual performing the work has an opportunity for profit or loss;

3. the furnishing of tools and the work place to the worker;
4. the permanency of the relationship;
5. the right to discharge;
6. whether the service rendered is an integral part of the alleged employer's regular business;
7. whether services are offered to the general public rather than to one individual;
8. the relationship the parties believe they are creating; and
9. whether fringe benefits are provided.

Adair v. Commissioner, T.C. Memo. 1995-493; Juliard v.Commissioner, T.C. Memo 1991-230.

Usually, cases that consider the above factors are concerned about whether a worker is an employee or an independent contractor, but the principles are equally applicable to determine by whom an individual is employed. See Professional & Executive Leasing, Inc., 89 T.C. 232, aff'd, 862 F.2d 751 (9th Cir. 1988).

ANALYSIS:

The information received from the Tax Council suggests that the United States has the right to control its service members far in excess of the right found in typical employer-employee relationships, regardless of where the service members are assigned to perform duty. Arguably, therefore, service members are per se employees of the United States. Nonetheless, it is appropriate to analyze the circumstances of the service member's assignment under the common law test. Applying the common law test to service members assigned to NATO,[1] we conclude that the members are employees of the United States. It should be noted that the exception to section 911 requires only a determination of whether the individual is an employee of the United States, not whether the individual is an employee of only the United States. The facts in this case support the conclusion that a service member assigned to NATO is an employee of the United States and not of NATO. However, the common law includes a doctrine of coemployment, under which an individual may have a separate employment relationship with each of two parties, thereby being an employee of each. Therefore, a conclusion that an individual is an employee of NATO would not necessarily preclude a conclusion that the individual is also an employee of the United States for purposes of section 911.

[1] We have considered a generic description of a service member assigned to NATO. We note that the results of applying the common law test may depend upon what position the service member holds at NATO.

A service member is assigned to NATO by the United States and performs services at NATO as a member of the United States military. He represents the United States at NATO. He is under the command of a United States Commander and is evaluated by the United States Commander. The United States continues to provide the member with all benefits, pays the member's salary and issues a Form W-2. Both the service member and the United States intend that the member's relationship with the United States continue. For example, a service member may not cash out any accrued leave when assigned to NATO. A service member is not allowed to take a loyalty oath to NATO. A service member at NATO does not abandon his duty to the United States. The United States is engaging in an integral part of the business of government by allowing members of the Armed Forces to serve at NATO. NATO has no authority to remove a member from the Armed Forces and very limited authority to remove a service member from a NATO position. The service member's relationship with NATO is temporary. These facts, in addition to the actual control exercised by the United States, lead to the conclusion that the service member is an employee of the United States who is merely assigned to NATO.

Two facts suggest that a member of the Armed Forces assigned to NATO is employed by NATO. First, NATO furnishes the workplace. However, this is generally not a determinative factor. Second, a service member assigned to NATO might have a foreign military commander as his supervisor. The exercise of day-to-day supervision indicates the right to direct and control the worker. In Adair, the Tax Court noted NATO's exclusive direction over Mr. Adair's daily activities, and thus, a court might find that actual control existed and based upon Adair conclude that NATO was the employer.

Notwithstanding the above, Adair does not mandate the conclusion that a service member assigned to NATO is not an employee of the United States. The circumstances of a service member assigned to NATO are quite different from those of a civilian transferee under FEIOSA. Service members are not governed by FEIOSA. Unlike a civilian transferee, it is unnecessary to encourage service members to transfer to international organization. The United States orders a service member where to report for duty, and the member cannot object to the change of duty station. It is also unnecessary to provide reemployment rights because, when a service member is assigned to a new position, he does not terminate his relationship with the United States. Members are governed by the UCMJ and can be removed from their respective service only by the United States. Thus, even in circumstances where the service member is supervised daily by someone other than a United States Commander, Adair is distinguishable. Based upon all of the facts and circumstances discussed above, we conclude that the service members are employees of the United States.

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If you have any questions, please call Kate Y. Hwa at (202) 622-3840.

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