

Effective date.—These provisions are effective for taxable years beginning after December 31, 1966.

c. Foreign community property income (sec. 105(e) of the act and new sec. 981 of the code)

Prior law.—The general income tax provisions provide, in effect, that the worldwide income of a U.S. citizen is subject to tax from whatever source derived. In a recent case,⁴ it was held that an American citizen who acquired residence in a foreign country with community property laws, and who married a nonresident alien, had a sufficient interest in one-half of the marital partnership income—even though earned by the husband foreigner—to render her subject to U.S. taxation on that income.

Explanation of provisions.—The act provides U.S. citizens who are, during the periods involved, married to nonresident aliens with two separate elections, one for post-1966 years and one for pre-1966 years.

If an election is made for post-1966 years, the community income of husband and wife are to be treated as follows:

(1) Earned income (sec. 911(b)) is to be treated as income of the spouse who rendered the personal services.

(2) Trade or business income is to be treated as income of the husband unless the wife exercises substantially all the management and control over the business. Also, a partner's distributive share of income is to be wholly attributed to him (same as self-employment rules under section 1402(a)(5)).

(3) Other community income which is derived from separate property of one spouse is to be treated as income of that spouse. What is "separate property" for this purpose is to be determined under the applicable foreign community property law.

(4) All other community income is to be treated as provided in applicable foreign community property law.

For pre-1967 years the treatment of income of the types set forth in categories (1), (2), and (3) above is to be the same as described above, but the income described in category (4) above is to be treated as income of the spouse who, for the year involved, had the greater amount of income described in (1), (2), and (3) plus separate income. Thus, category (4) income is attributed to the marital partner whose earnings or property were most likely to have given rise to this income.

For purposes of this provision, the treatment of deductions is to be compatible with that accorded the income to which the deductions are attributable. In other words deductions are to follow the income they generate.

This provision provides qualified taxpayers with two elections, one for pre-1967 years and one for future years. Either election can be made for any year, at any time, so long as the year is still open. However, these elections are binding—if the election is exercised for any post-1967 year the treatment provided by this provision applies not only to the year of election but also to all years subsequent which are open and, if made for pre-1967 years, this provision applies for all open years prior to that date. It should be noted that either election can be made separately.

⁴ *Katrushka J. Parsons v. Commissioner*, 43 T.C. 331 (1964).