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Fourth Circuit: Payments to Russian scientist—taxable compensation or exempt from tax as a grant?

The U.S. Court of Appeals for the Fourth Circuit today reversed a decision of the U.S. Tax Court, and held that payments made to the taxpayer (a Russian scientist working in the United States) were not exempt from tax under provisions of the United States-Russia income tax treaty.

However, the appeals court remanded the case for further determination as to the nature of the payments made to the taxpayer—that is, whether with the payments there was a quid pro quo that distinguished compensation for employment from a "no-string" grant.

The case is: *Baturin v. Commissioner*, No. 20-1648 (4th Cir. April 6, 2022). Read the Fourth Circuit's **decision** [PDF 191 KB]

Summary

The taxpayer (a Russian national and physicist) worked at a U.S. Department of Energy facility in Virginia, as part of a project operating a particle accelerator (which smashes particles together to help researchers learn about the structure of the universe).

The taxpayer held a J-1 exchange visitor visa as a sponsored researcher. He received W-2s that reflected income of approximately $77,000 in 2010 and $79,000 in 2011 for "wages, tips, [or] other comp[ensation]." He filed Form 1040-NR (nonresident returns) with the IRS, on which he claimed an exemption as to the entire amount earned each year pursuant to Article 18 of the United States-Russia income tax treaty.

In 2014, the IRS issued a notice of deficiency, asserting that the taxpayer owed over $22,000 in income taxes on the amounts for 2010 and 2011. The taxpayer asserted that the treaty exempted his income from taxation. The IRS countered that wages were, by definition, ineligible for the Article 18 exemption.

The Tax Court in a 2019 opinion held that wages may be eligible for the Article 18 exemption as long as they are payments similar to a grant or an allowance. The Tax Court concluded that the taxpayer's

wages were payments similar to a grant or an allowance and, therefore, were exempt from federal income tax.

The government appealed, and the Fourth Circuit today reversed, noting that the Tax Court had misunderstood the basis of the treaty's distinction between a tax-exempt "grant, allowance, or other similar payments" and taxable "salaries, wages, and other similar remuneration." As the appeals court explained, the text of the treaty does not define what differentiates "salaries, wages, and other similar remuneration" in Article 14 from a "grant, allowance, or other similar payments" in Article 18. However, within the text of the treaty, these categories are mutually exclusive, given the simple fact that one is taxable and the other is not. Further, the appeals court found that the legislative history of the treaty's ratification reinforced the conclusion that salaries and grants are exclusive categories.

The Fourth Circuit held that given the treaty's text and history, it must reject the Tax Court's holding that under the treaty, "wages may be eligible for exemption so long as they are similar to a grant or allowance."

However, the appeals court remanded the case back to the Tax Court for a clarification of the taxpayer's relationship with the Virginia facility and specifically for a determination as to whether there was a "requirement of any substantial quid pro quo" that distinguished compensation for employment from a "relatively disinterested, 'no-string'" grant.