Sverdrup v. Commissioner, 14 T.C. 859 (1950)

Amounts paid by the United States to a U.S. citizen residing abroad for more than six months are not exempt from gross income, even if the income is earned income from sources outside the U.S.

Summary

Leif Sverdrup, a U.S. citizen and partner in an engineering firm, worked outside the U.S. for more than six months in 1942. He sought to exclude income earned from contracts with the U.S. government from his gross income, arguing it was earned income from sources outside the U.S. under Section 116(a) of the Internal Revenue Code. The Tax Court held that the income was not excludable because it fell under the exception for "amounts paid by the United States or any agency thereof," even though the income was earned outside of the United States.

Facts

Leif Sverdrup was a U.S. citizen and a partner in the engineering firm Sverdrup & Parcel. The partnership engaged in a joint venture with J. Gordon Turnbull to perform contracts related to the U.S. national defense program. Sverdrup worked outside the continental U.S., Hawaii, and Alaska from November 1941 to April 1942, overseeing construction projects in the South Pacific. He selected sites, supervised surveys, and arranged for labor and materials. The partnership received payments from the U.S. government under these contracts, depositing the funds into the joint venture's bank account, and then distributed a share to Sverdrup. Sverdrup also received additional compensation of $5,000 from the joint venture.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Sverdrup's income tax for 1943, stemming from the 1942 tax year. Sverdrup petitioned the Tax Court, contesting the Commissioner's determination that certain income was not excludable under Section 116(a) of the Internal Revenue Code.

Issue(s)

Whether amounts received by a U.S. citizen, who is a bona fide nonresident of the United States for more than six months during the taxable year, from contracts with the U.S. government for services performed outside the U.S., are excludable from gross income under Section 116(a) of the Internal Revenue Code, prior to its amendment by the Revenue Act of 1942 and Revenue Act of 1943.

Holding

No, because the amounts were "paid by the United States," and therefore fall within the exception to the exclusion provided by Section 116(a) for income earned abroad

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by U.S. citizens.

Court’s Reasoning

The court reasoned that because the funds originated from the U.S. government, the income was “paid by the United States,” regardless of the intermediate entities (joint venture and partnership). Citing *Craik v. United States*, the court emphasized that partnership income is treated as though each partner received their distributive share directly. The court rejected Sverdrup’s argument that the exception only applied to employees of the U.S., pointing to the broad language of the statute: “except amounts paid by the United States or any agency thereof.” The court did find that the $5,000 paid by the Joint Venture was excludable, as it was considered compensation paid by the joint venture, not directly by the United States.

Practical Implications

This case clarifies that the exception in Section 116(a) for amounts paid by the U.S. government applies broadly to any payments originating from the U.S. government, even if the income is earned outside the U.S. and would otherwise qualify for exclusion. It illustrates the importance of tracing the source of income when determining eligibility for tax exclusions related to foreign earned income. Later cases distinguish this ruling by focusing on whether the payment truly originated from the U.S. government, emphasizing that payments made by private entities, even if those entities receive government funding, may not fall under the “paid by the United States” exception.

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