20 T.C. 151 (1953)

A non-resident alien actively managing U.S. real estate through a resident agent is considered to be engaged in a U.S. trade or business and is therefore subject to U.S. income tax on gains from the sale of that property, notwithstanding tax treaty provisions regarding capital assets.

Summary

Jan Lewenhaupt, a Swedish citizen and resident, challenged a tax deficiency assessed on the capital gain from the sale of U.S. real property. He argued that the U.S.-Sweden tax treaty exempted such gains. The Tax Court held that Lewenhaupt was engaged in a U.S. trade or business due to his active management of U.S. real estate through an agent, making the capital gain taxable under U.S. law. The court found that managing multiple properties and engaging in activities beyond mere ownership constituted a U.S. business, overriding the treaty's capital gains exemption.

Facts

Lewenhaupt, a Swedish citizen, owned several pieces of real property in the United States. He appointed Clinton LaMontagne as his agent with broad powers to manage these properties, including buying, selling, leasing, and mortgaging real estate. LaMontagne managed the properties, collected rents, paid expenses, and supervised repairs. In 1946, Lewenhaupt sold a property in Modesto, California, realizing a significant capital gain. Lewenhaupt spent only one month in the U.S. that year and performed no personal services in the U.S. before 1948.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Lewenhaupt's 1946 income tax due to the inclusion of the capital gain from the sale of the Modesto property. Lewenhaupt contested the deficiency in the Tax Court, arguing that the gain was exempt under the U.S.-Sweden tax treaty.

Issue(s)

1. Whether the provisions of Article IX of the U.S.-Sweden tax convention exempt capital gains derived from the sale of U.S. real property by a Swedish resident.

2. Whether Lewenhaupt was engaged in a trade or business within the United States during the taxable year.

Holding

1. No, because Article V of the tax convention governs the taxability of income derived from real property, including gains from the sale of such property, and

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Article IX does not apply.

2. Yes, because Lewenhaupt's activities with respect to his U.S. real estate constituted engaging in a business within the meaning of section 211 (b) of the Internal Revenue Code.

Court's Reasoning

The court reasoned that while Article IX of the tax treaty generally exempts capital gains from taxation if the resident of the other contracting state has no permanent establishment in the taxing state, Article V specifically addresses income from real property, including gains from its sale. The court relied on Senate Executive Reports to interpret the treaty, concluding that it aimed to avoid double taxation, not to exempt income from both countries' taxes. It also emphasized that the treaty's definition of "permanent establishment" was similar to the U.S. tax code's concept of "United States business or office." The court found Lewenhaupt's activities, conducted through his agent LaMontagne, went beyond mere passive ownership. These activities were "considerable, continuous, and regular and, in our opinion, constituted engaging in a business within the meaning of section 211 (b) of the Code."

Practical Implications

This case clarifies that non-resident aliens actively managing U.S. real estate can be deemed to be engaged in a U.S. trade or business, subjecting them to U.S. income tax on related gains, even if they are not physically present in the U.S. It emphasizes the importance of examining the extent of management activities when determining tax liability. It also illustrates how tax treaties are interpreted in conjunction with domestic tax laws and regulations. The level of activity, delegation to agents, and the scale of the real estate holdings are key factors in determining whether a non-resident alien is engaged in a U.S. trade or business. Later cases cite Lewenhaupt for the proposition that active management of real estate, rather than passive ownership, triggers U.S. business status for non-resident aliens.

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