30 T.C. 456 (1958)

Wages paid to a U.S. citizen by a private shipping company acting as an agent for the U.S. government, from funds specifically provided by the government, are considered to be paid by a U.S. agency and are therefore not excludable from gross income, even if earned abroad.

Summary

The case concerns a radio operator working on a U.S.-owned ship during the Korean War who sought to exclude his wages from gross income, claiming they were earned abroad and met the statutory requirements for exclusion. The IRS argued the wages were paid by a U.S. agency and thus ineligible for exclusion, regardless of where the work was performed. The Tax Court sided with the IRS, holding that the funds for the wages came directly from the U.S. government, paid through its agent, a private shipping company. The court relied on the substance of the transaction – the ultimate source of the funds – rather than the technicalities of the employment relationship, to determine taxability.

Facts

Robert W. Teskey, a U.S. citizen, worked as a radio operator aboard the vessel *Rose Knot*, owned by the U.S. Maritime Administration, Department of Commerce, between January 1952 and February 1954. The vessel was operated under a General Agency Agreement between the U.S. and Pacific-Atlantic S.S. Co. (the agent). Under this agreement, the U.S. provided funds to Pacific-Atlantic for operating expenses, including wages. Teskey was hired through a union hiring hall, and Pacific-Atlantic handled his pay, withholding taxes. The vessel sailed between Japan and Korea in shuttle service during the Korean War. Teskey met the presence requirements for the foreign earned income exclusion under 26 U.S.C. § 116 and 911.

Procedural History

The IRS determined deficiencies in Teskey's income tax for 1953 and 1954, disallowing the foreign earned income exclusion, initially claiming he did not reside in a foreign country for the required length of time. After considering the facts, the Commissioner changed the argument to contend that Teskey's wages were paid by the United States or one of its agencies. The Tax Court heard the case and ruled in favor of the Commissioner.

Issue(s)

Whether wages paid by a private shipping line, acting as a general agent for the United States, from funds provided by the United States to a U.S. citizen for services performed on a U.S.-owned vessel, are considered amounts paid by the United States or its agency within the meaning of the Internal Revenue Code, thus rendering them non-excludable from gross income.

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Holding

Yes, because the court found that even though Pacific-Atlantic, a private shipping line, paid Teskey, the wages were ultimately derived from funds provided by the U.S. government. The court held that the funds were paid by a U.S. agency and the wages were not excludible from gross income.

Court's Reasoning

The court focused on the source of the funds, holding that the substance of the transaction was that the U.S. government was providing the funds for the wages, even though a private company was the disbursing agent. The court specifically referenced Revenue Ruling 58-4, which addressed a similar situation, and found it to be a correct application of the law. The court highlighted the broad language of the statute, noting that the exclusion applied to amounts paid by "the United States or any agency thereof" and did not specify whether the employee had to be employed by the government. The court quoted the *Leif J. Sverdrup* case, emphasizing that the source of the payment was crucial in determining its taxability.

Practical Implications

This case clarifies that the source of payment is the determining factor in the application of the foreign earned income exclusion when the government is involved. It emphasizes that the form of the transaction (e.g., using an agent to pay) does not control; instead, the ultimate source of the funds decides taxability. This impacts how taxpayers and the IRS analyze similar situations involving government-funded employment. The ruling suggests that if the government, or an agency thereof, provides the funds used to pay an individual, the income is likely taxable, regardless of the nature of the employer. The case reinforces the principle of looking at the substance over form in tax matters. It also underscores the importance of understanding the specific details of contractual agreements, such as general agency agreements, to determine the ultimate source of funds. Future cases involving contractors working for the government in foreign countries will rely on this precedent.

Meta Description

This case explains when wages earned abroad are considered paid by a U.S. agency, thus, are not eligible for a foreign income exclusion, regardless of the worker's employment status.

Tags

Teskey, U.S. Tax Court, 1958, Foreign Earned Income Exclusion, Agency, Government Funding, Source of Funds

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