Tobey v. Commissioner, 61 T. C. 236 (1973)

Income from the sale of paintings created by an artist's personal efforts qualifies as "earned income" under section 911(b) of the Internal Revenue Code, and thus may be excluded from gross income if the artist is living abroad.

Summary

In Tobey v. Commissioner, the U. S. Tax Court ruled that income derived from Mark Tobey's sale of paintings created while living in Switzerland was "earned income" under section 911(b), thus allowing him to exclude $25,000 per year from his gross income. The court rejected the IRS's argument that such income was from the sale of personal property rather than personal services, emphasizing that the distinction between earned and unearned income hinges on the presence or absence of capital as an income-producing factor, not the existence of a tangible product or a recipient of services. This decision clarified the tax treatment of income from artistic works and aligned it with the legislative intent to favor income from personal efforts over passive income.

Facts

Mark Tobey, a U. S. citizen residing in Basel, Switzerland since 1960, created paintings sold through galleries in the U. S. and Europe. In 1965 and 1966, he received $106,450 and $59,956 respectively from sales of works created abroad, after paying commissions. Tobey claimed these amounts as "earned income" and excluded $25,000 per year from his gross income under section 911(a), which allows U. S. citizens living abroad to exclude certain foreign-earned income. The IRS challenged these exclusions, asserting that income from painting sales was not "earned income" but rather income from the sale of personal property.

Procedural History

Tobey filed Federal income tax returns for 1965 and 1966, claiming the section 911 exclusion. The IRS audited these returns, disallowed the exclusions, and assessed deficiencies of $10,283. 89 for 1965 and $5,372. 38 for 1966. Tobey filed an amended petition with the U. S. Tax Court, claiming overpayments for these years. The Tax Court reviewed the case, leading to the opinion that the income from Tobey's paintings was indeed "earned income. "

Issue(s)

1. Whether income derived from the sale of Mark Tobey's paintings, created while living in Switzerland, constitutes "earned income" within the meaning of section 911(b) of the Internal Revenue Code?

Holding

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1. Yes, because the income from the sale of Tobey's paintings resulted from his personal efforts and not from the use of capital, thus qualifying as "earned income" under section 911(b).

Court's Reasoning

The court relied on the legislative history of section 911(b) and the precedent set by Robida v. Commissioner, which established that "earned income" includes income derived from personal efforts, not just wages or salaries, but also income from applying personal skills, even without a direct recipient of services. The court emphasized that the key distinction is between income derived from personal efforts and income derived from capital. In Tobey's case, capital was not a material income-producing factor; his income came solely from his personal efforts in creating art. The court rejected the IRS's argument that the sale of a tangible product (paintings) precluded classification as "earned income," noting that Congress intended a broad definition of "earned income" to include all income not representing a return on capital. The court also dismissed prior rulings and administrative positions that distinguished between income from personal services and income from property sales, finding them inconsistent with the legislative intent.

Practical Implications

The Tobey decision has significant implications for artists and other creative professionals living abroad. It clarifies that income from creative works, when resulting from personal efforts and not capital, qualifies as "earned income" under section 911(b), thus eligible for exclusion from gross income. This ruling aligns the tax treatment of artists with other professionals, ensuring equitable treatment under tax law. Practitioners should note that the absence of a direct recipient of services or a tangible product does not disqualify income from being "earned. " This case also influenced subsequent legislative changes, such as amendments to section 401(c)(2) regarding self-employed individuals' retirement plans, which now explicitly include gains from the sale of property created by personal efforts as "earned income. " Legal professionals advising clients on international tax issues should consider this ruling when structuring income for artists and similar professionals living abroad.

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