***Cornman v. Commissioner*, 63 T.C. 942 (1975)**

Section 911(a) of the Internal Revenue Code, which disallows deductions allocable to excluded foreign earned income, does not prevent a U.S. citizen residing abroad from deducting ordinary and necessary business expenses when no foreign earned income was actually excluded during the tax year.

Summary

Ivor Cornman, a U.S. citizen and bona fide resident of Jamaica, sought to deduct business expenses related to his biological research conducted in Jamaica during 1970. Although he incurred expenses, his research generated no income in 1970. The IRS argued that Section 911(a) disallows these deductions because they were allocable to potentially exempt foreign income, even though no income was actually earned or excluded. The Tax Court held that Section 911(a) only disallows deductions when there is actual foreign earned income excluded under that section. Since Cornman had no excluded income in 1970, he was permitted to deduct his ordinary and necessary business expenses under Section 162(a).

Facts

Petitioner Ivor Cornman, a U.S. citizen, was a bona fide resident of Jamaica since 1963. In 1970, his principal residence was in Jamaica. Cornman was self-employed in biological research, seeking to isolate organic substances for pharmaceutical products, a pursuit requiring a tropical environment, hence his residence in Jamaica. In 1970, his research activities generated no income. He maintained his research operations to be ready for new clients, collect materials, conduct basic research, and explore new income sources. Cornman incurred $7,496 in research-related expenses in 1970, including salaries, rent, transportation, and storage. His wife received a salary from these research activities for secretarial and lab technician services, which was excluded from their joint U.S. tax return as foreign earned income.

Procedural History

The IRS determined a deficiency in Cornman’s 1970 federal income tax, disallowing the deduction of his research expenses. Cornman petitioned the Tax Court for review. The Tax Court considered whether Section 911(a) prevented the deduction of these expenses.

Issue(s)

1. Whether Section 911(a) of the Internal Revenue Code disallows the deduction of ordinary and necessary business expenses incurred by a U.S. citizen residing abroad when no foreign earned income was excluded under Section 911(a) during the tax year.
2. Whether expenses paid to a spouse and excluded as the spouse’s foreign earned income are considered “properly allocable to or chargeable against

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amounts excluded from gross income" by the other spouse under Section 911(a), thus disallowing that spouse's deduction.

Holding

1. Yes, in favor of the taxpayer. Section 911(a) does not disallow deductions when no foreign earned income is actually excluded because the statute explicitly requires that deductions be "properly allocable to or chargeable against amounts excluded from gross income," and in this case, no income was excluded.
2. No. The wife's excluded income is not attributable to the husband for the purpose of disallowing his business expense deductions under Section 911(a). The deduction claimed by the husband is considered separately and is allocable to his potential (but unrealized) earned income, not his wife's actual earned income.

Court's Reasoning

The court reasoned that the plain language of Section 911(a) disallows deductions only when they are "properly allocable to or chargeable against amounts excluded from gross income." Since Cornman earned no income from his research in 1970, and therefore excluded no foreign earned income, there were no "amounts excluded from gross income" to which his expenses could be allocated. The court emphasized the double tax benefit rationale behind Section 911(a)—to prevent taxpayers from deducting expenses related to income that is already exempt from taxation. However, in the absence of excluded income, there is no risk of a double benefit. The court distinguished cases where some foreign income was earned and excluded, noting that in those cases, deductions were properly disallowed on a pro-rata basis. Regarding the wife's income, the court determined that the legislative history and IRS Form 2555 indicate that Section 911(a) operates on an individual basis. The wife's excluded income is not attributable to the husband for the purposes of disallowing his deductions. The court stated, "We are persuaded by the legislative history of section 911, the statutory language limiting the exclusion thereunder to an 'individual' receiving compensation for 'personal' services...that the 'earned income' excluded by petitioner's wife in 1970 is in no way attributable to petitioner." The court concluded that Congress intended to deny deductions only when there was a clear double tax benefit, which was not the case here where no income was earned or excluded by the petitioner.

Practical Implications

This case clarifies that Section 911(a) deduction disallowance is triggered only when there is actual foreign earned income excluded under that section. It provides a significant benefit to U.S. citizens residing abroad who are engaged in business activities that may not generate immediate foreign income. Legal practitioners should advise clients that business expenses incurred while residing abroad are

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deductible under Section 162(a) in years where no foreign earned income is excluded, even if the activities are intended to generate foreign income in the future. This ruling limits the IRS's ability to broadly interpret Section 911(a) to disallow deductions in the absence of actual excluded income. It emphasizes a strict interpretation of the statute, focusing on the explicit requirement of "amounts excluded from gross income." Later cases would need to distinguish situations where income is deferred or expected in subsequent years, but for the tax year in question, absent excluded income, deductions are permissible.

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