Williams v. Commissioner, 64 T. C. 1085 (1975)

Commissions received by a real estate salesman on transactions where the salesman purchases property for their own account must be included in gross income.

Summary

In Williams v. Commissioner, the U. S. Tax Court ruled that commissions earned by a real estate salesman on transactions where he purchased properties for his own account were taxable income. Jack Williams, a salesman for Dart Industries, received commissions on properties he bought for himself and tried to exclude them from gross income. The court found these commissions to be compensation for services rendered, not a reduction in purchase price. Additionally, the court addressed commissions from a transaction with a third party, Mr. Fisher, which Williams later repurchased to protect his commissions. The decision clarifies that such commissions are taxable regardless of the nature of the transaction, reinforcing the principle that compensation for services is always includable in gross income.

Facts

Jack Williams worked as a real estate salesman for Dart Industries in 1971, earning a 10% commission on each transaction he facilitated. That year, Williams purchased properties from Dart for his own account, receiving commissions on these transactions. He also arranged a sale to Mr. Fisher, receiving a commission, and later repurchased the property from Fisher to protect his initial commission when Fisher defaulted. Williams included these commissions in his gross receipts but deducted them as “Reimbursements and Finder’s Fees,” effectively excluding them from his gross income on his 1971 tax return.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Williams’ 1971 tax return and challenged the exclusion of these commissions from gross income. The case was submitted under Rule 122 of the Tax Court Rules of Practice and Procedure, with all facts stipulated by the parties. The Tax Court ultimately ruled in favor of the Commissioner, requiring Williams to include the disputed commissions in his gross income.

Issue(s)

1. Whether a real estate salesman may exclude from gross income commissions received from transactions in which he purchased property for his own account.
2. Whether a real estate salesman may exclude from gross income commissions received on a transaction with a third party, which he later repurchased to protect his initial commission.

Holding

1. No, because the commissions received by Williams were compensation for services rendered to his employer, Dart Industries, and thus must be included in his gross income.
2. No, because the commissions received on the transaction with Mr. Fisher were also compensation for services rendered, and the subsequent repurchase to protect the commission does not alter their character as income.

Court's Reasoning

The court applied section 61(a)(1) of the Internal Revenue Code, which defines gross income to include compensation for services, specifically mentioning commissions. The court followed the precedent set in Commissioner v. Daehler, emphasizing that commissions received by an employee for services rendered are taxable income, regardless of whether the employee is the buyer in the transaction. The court rejected Williams' argument that the commissions were a reduction in the purchase price, noting that the commissions were payments for services, not a discount on the property price. The court also distinguished this case from Benjamin v. Hoey, where the taxpayer was a partner in a firm and the situation involved different legal relationships. In a concurring opinion, Judge Forrester agreed with the majority but noted that the repurchase from Fisher could be capitalized as part of the cost of the Fisher properties to prevent a refund of the commission to Dart.

Practical Implications

This decision reinforces the principle that commissions earned by employees must be included in gross income, even if they arise from transactions where the employee is also the buyer. Legal practitioners advising real estate salesmen or similar professionals should ensure clients understand that commissions received on self-purchases are taxable. This ruling may affect how real estate companies structure their compensation arrangements, as it clarifies that commissions paid to employees are taxable income. Subsequent cases, such as George E. Bailey, have followed this precedent, affirming the taxability of commissions in similar contexts. This decision also has implications for other professions where individuals might receive commissions on transactions involving themselves, such as insurance agents or stockbrokers.