Duncan v. Commissioner, 86 T. C. 971 (1986)

U. S. citizens are subject to self-employment tax on foreign earnings unless exempted by a specific treaty provision or agreement.

Summary

John B. Duncan, a U. S. citizen and Canadian resident, worked as a minister in Canada and challenged the IRS's imposition of self-employment tax on his 1979 earnings. The Tax Court held that Duncan was liable for the tax because the U. S. -Canada tax treaty's savings clause allowed the U. S. to tax its citizens as if the treaty did not exist, and no other exemptions applied. This decision emphasizes the broad scope of U. S. taxing authority over its citizens' worldwide income and the limitations of treaty exemptions.

Facts

John B. Duncan, a U. S. citizen residing in Canada, worked as an ordained minister at a Presbyterian Church in Ontario during 1979. He earned the equivalent of $17,498 in U. S. dollars and was covered by the Canadian pension system. Duncan did not file for an exemption from U. S. self-employment tax nor did he pay any such tax on his Canadian earnings. The IRS determined a deficiency in his 1979 federal income tax, asserting that his ministerial earnings were subject to self-employment tax under section 1401 of the Internal Revenue Code.

Procedural History

The IRS issued a notice of deficiency on February 2, 1983, asserting a deficiency in Duncan's 1979 federal income tax. Duncan petitioned the U. S. Tax Court, which heard the case on the stipulated facts. The Tax Court's decision was rendered on May 19, 1986.

Issue(s)

1. Whether the income earned by Duncan as a minister in Canada is subject to U. S. self-employment tax under section 1401 of the Internal Revenue Code.

Holding

1. Yes, because Duncan, as a U. S. citizen, is subject to self-employment tax on his worldwide income, and no exemption under the U. S. -Canada tax treaty applied to his situation.

Court's Reasoning

The court applied section 1401 of the Internal Revenue Code, which imposes self-employment tax on U. S. citizens' worldwide income. Duncan argued that the U. S. -

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Canada tax treaty exempted his income from U. S. taxation, but the court disagreed. The court noted that the treaty's savings clause (Article XXIX, paragraph 2) allowed the U. S. to tax its citizens as if the treaty did not exist. The court found that the treaty provisions Duncan relied upon (Articles XIV and XV) were not in effect during 1979 and, even if they were, the savings clause would still apply. Duncan did not qualify for any other exemptions under the Code, such as filing for an exemption under section 1402(e) or benefiting from the U. S. -Canada Social Security Agreement, which was not yet in effect. The court concluded that Duncan's income was subject to U. S. self-employment tax. The court cited Filler v. Commissioner (74 T. C. 406 (1980)) to support its interpretation of the treaty's savings clause.

Practical Implications

This decision clarifies that U. S. citizens working abroad remain subject to U. S. self-employment tax unless a specific treaty provision or agreement exempts them. Attorneys advising U. S. citizens with foreign earnings must carefully analyze any applicable treaties and ensure clients comply with exemption requirements. The case underscores the importance of the savings clause in U. S. tax treaties, which preserves the U. S. 's right to tax its citizens. Practitioners should also be aware of the timing of treaty provisions and social security agreements, as these can impact tax liability. This ruling has been followed in subsequent cases, such as Priebe v. Commissioner (T. C. Memo 1986-162), reinforcing its significance in international tax law.

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