Soboleski v. Commissioner, 88 T. C. 1024 (1987)

Salary payments to U. S. government employees working abroad on projects funded by foreign governments are not excludable from gross income under the foreign earned income exclusion.

Summary

In Soboleski v. Commissioner, Joseph Soboleski, a U. S. Army Corps of Engineers employee stationed in Saudi Arabia, sought to exclude his salary from taxable income under Section 911(a) of the Internal Revenue Code, which allows for the exclusion of foreign earned income. The U. S. Tax Court held that Soboleski's salary, funded by Saudi Arabia but disbursed by the U. S. government, was not excludable because it was paid by a U. S. agency. The court emphasized the legal relationship between the employee and the U. S. government, rather than the ultimate funding source, as determinative of the exclusion's applicability.

Facts

Joseph Soboleski, a U. S. citizen and civil engineer employed by the U. S. Army Corps of Engineers, was assigned to supervise construction projects in Saudi Arabia under the Engineering Assistance Agreement (EAA). The Saudi Arabian government funded these projects in advance, but Soboleski's salary was paid by the Corps using U. S. Treasury checks. Soboleski attempted to exclude his salary from his taxable income under Section 911(a), which excludes certain foreign-earned income, but the IRS denied the exclusion.

Procedural History

Soboleski and his wife filed a petition with the U. S. Tax Court challenging the IRS's determination of deficiencies in their federal income tax for 1980 and 1981. The Tax Court ruled in favor of the Commissioner, holding that Soboleski's salary was paid by a U. S. government agency and thus not excludable under Section 911(a).

Issue(s)

1. Whether salary payments received by a U. S. government employee for work performed in Saudi Arabia, funded by the Saudi government but disbursed by the U. S. government, are excludable from gross income under Section 911(a) of the Internal Revenue Code.

Holding

1. No, because the salary payments were made by the U. S. Army Corps of Engineers, a U. S. government agency, and thus fall under the exception to the foreign earned income exclusion provided in Section 911(a).

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Court’s Reasoning

The Tax Court applied a facts and circumstances test to determine whether Soboleski’s salary was paid by the U. S. government. The court focused on the legal relationship between Soboleski and the U. S. government, noting that Soboleski was employed by the Corps, received his salary directly from the Corps, and had no direct claim against the Saudi government for payment. The court rejected the argument that the ultimate source of the funds (Saudi Arabia) was determinative, emphasizing instead the legal obligation of the U. S. government to pay Soboleski’s salary. The court also cited prior cases, such as *Smith v. Commissioner* and *Commissioner v. Wolfe*, which established that the employer-employee relationship and the method of payment were key factors in determining the applicability of the Section 911(a) exclusion. The court concluded that Soboleski’s salary was paid by the U. S. government and thus not eligible for the foreign earned income exclusion.

Practical Implications

This decision clarifies that U. S. government employees working abroad on projects funded by foreign governments cannot exclude their salaries from U. S. taxable income under Section 911(a). Legal practitioners advising clients on international tax matters must consider the legal relationship between the employee and the employer, rather than the source of funding, when assessing eligibility for the foreign earned income exclusion. This ruling impacts U. S. government agencies involved in international projects, as they must inform employees that their salaries remain taxable despite being funded by foreign governments. Subsequent cases, such as *Wagner v. United States*, have followed this reasoning, reinforcing the principle that the legal employer, not the funding source, determines tax treatment under Section 911(a).

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