6 T.C. 899 (1946)

Income derived from a business that depends primarily on an individual's personal services, skill, and attention is taxable to that individual, even if there's an agreement to assign the income to another.

Summary

Wade Allen operated a cinema theater, Arcade Theatre, for over ten years. He agreed with his wife that the earnings from this theater should go to her. However, in the taxable year, his wife was ill and unable to contribute any services to the business. The Tax Court held that Allen was taxable on the income from Arcade Theatre under Section 22(a) of the Internal Revenue Code, because the income was primarily attributable to his personal services and skill, not his wife's. This case illustrates the principle that income is taxed to the one who earns it, especially when it results from personal services.

Facts

Wade Allen operated two movie theaters: Arcade Theatre and Fine Arts Theatre.

Allen and his wife, Margaret, were estranged but still resided in the same house.

Allen and his wife agreed that she should receive all the earnings from Arcade Theatre, with Allen receiving $500 per year for booking the films.

Margaret Allen was ill and did not contribute any services or capital to Arcade Theatre during the taxable year.

Allen continued to select films and contract with film companies for Arcade Theatre.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Allen's income tax, including the earnings from Arcade Theatre in Allen's income.

Allen petitioned the Tax Court, arguing that the income was taxable to his wife.

The Tax Court ruled in favor of the Commissioner, holding that Allen was taxable on the Arcade Theatre income.

Issue(s)

Whether the income from the Arcade Theatre is taxable to Wade Allen, given his agreement that the earnings should go to his wife, who performed no services for the business during the taxable year.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

No, because the income from the Arcade Theatre was primarily attributable to Wade Allen's personal services, skill, and attention, developed over a ten-year period.

Court's Reasoning

The court emphasized that income is taxable to the person who earns it, particularly when it is derived from personal services and skill. Citing *Lucas v. Earl, 281 U.S. 111*, the court noted the principle that income must be taxed to him who earns it. "The question is controlled by the cardinal rules of the law of Federal income taxation that income is taxable to the person who earns the income…and that he who enjoys the economic benefit of income is taxable thereon."

The court found that Allen was responsible for the essential aspects of the business, including selecting and booking films, and managing the theater. Even though Mrs. Allen had a certificate for conducting the business under an assumed name, she didn't possess the knowledge and skill to operate the business and she did not devote time to the business in the taxable year. The business's profits were due to Allen's personal services and skill, which he developed over a period of ten years.

The court distinguished this case from situations where a wife contributes capital, management, or vital services to a business, citing *Commissioner v. Tower, 327 U.S. 280*. Allen couldn't simply "give" the business to his wife; she had to actively contribute to it to be considered the earner of the income.

Practical Implications

This case reinforces the importance of determining who actually earns income, especially in closely held businesses or family arrangements. Agreements to assign income to another party are not effective for tax purposes if the income is primarily generated by the personal services, skill, and efforts of the assignor.

Legal practitioners must carefully analyze the facts to determine who performs the essential services that generate income.

Later cases have cited *Allen v. Commissioner* to emphasize the principle of taxing income to the earner, even when formal arrangements suggest otherwise. It serves as a reminder that substance prevails over form in tax law. It clarifies that merely filing a business name or passively receiving income does not equate to

© 2025 SCOTUSreports.com. All rights reserved.