***T.C. Memo. 1947-244***

Income from a business is taxable to the donor, not the donee, when the donor retains substantial control and dominion over the business assets after the purported gift, especially when the donee lacks experience or involvement in the business's management.

**Summary**

J.M. Henson gifted his business assets to his wife but continued to manage the business as before. The Commissioner argued that Henson retained sufficient control over the business despite the gift, making him liable for the income tax. The Tax Court agreed, holding that because Henson continued to operate the business and his wife had no prior business experience, the income was taxable to him. This case illustrates that a mere transfer of title is insufficient to shift income tax liability if the donor retains control.

**Facts**

J.M. Henson operated a business as a sole proprietorship, J.M. Henson Co.
On August 1, 1943, Henson executed a written assignment of the business assets to his wife as a gift.
He filed a gift tax return and paid the associated tax.
Mrs. Henson had no prior business experience and did not participate in the management of the business.
After the gift, the business operations continued substantially the same, with Henson in full directing charge.

**Procedural History**

The Commissioner determined a deficiency in Henson's income tax, asserting that the business income after the gift was still taxable to him.
Henson petitioned the Tax Court for a redetermination of the deficiency.
The Tax Court reviewed the case, with one judge dissenting, and ruled in favor of the Commissioner.

**Issue(s)**

Whether the profits of J.M. Henson Co. from August 1, 1943, to the end of the year are taxable to Mrs. Henson, as a result of the gift, or to J.M. Henson, the donor, because of his continued dominion and control over the business.

**Holding**

No, because Henson retained sufficient dominion and control over the assets and income of the business after the gift, thereby making the income taxable to him, rather than to his wife, who had no business experience and took no part in the

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business’s management.

## Court’s Reasoning

The court relied on the principle that income is taxable to the one who controls the property that generates the income, citing cases like *Lucas v. Earl* and *Helvering v. Clifford*.
The court distinguished between a valid gift for gift tax purposes and a transfer sufficient to shift income tax liability.
Even though Henson made a gift to his wife, he continued to manage the business as before, exercising full control over its operations.
The court referenced the case of *Robert E. Werner, 7 T.C. 39*, where income was taxed to the husband who controlled the business, despite the wife being the nominal owner.
The court emphasized that Mrs. Henson’s lack of business experience and non-participation in management further supported the decision to tax the income to Henson. The court also cited *Simmons v. Commissioner, 164 Fed. (2d) 220*, noting the importance of whether the donor “removed the petitioner altogether from the partnership” versus retaining an economic interest and control.

## Practical Implications

This case emphasizes that a mere paper transfer of assets is insufficient to shift income tax liability. The IRS and courts will scrutinize whether the donor retains control over the income-producing property.
To effectively shift income tax liability, the donee must have genuine control and involvement in the business or asset’s management.
This ruling impacts family businesses and estate planning, requiring careful consideration of control and management roles to avoid unintended tax consequences.
Later cases have cited Henson to reinforce the principle that substance prevails over form in determining income tax liability, particularly in situations involving gifts or transfers between family members. It highlights the importance of documenting the donee’s active role in the business for tax purposes.

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