*14 T.C. 217 (1950)*

Payments from an employer to an employee are presumed to be taxable compensation for services rendered, not tax-free gifts, especially when the payments are linked to the employee's performance or position.

**Summary**

The Tax Court ruled that payments made by a company to its employee, although labeled as 'gifts,' constituted taxable compensation. The payments were made during a period of wage stabilization when direct salary increases were restricted. The court emphasized that the intent of the payor, gathered from the surrounding circumstances, and the presence of consideration (even indirect) are key factors. The court determined that the payments were intended to supplement the employee's income due to his services and loyalty, rather than as genuine gifts.

**Facts**

Stanton was an employee of a family partnership managed by Jacobshagen. During 1943 and 1944, Jacobshagen, aware of wage stabilization laws preventing salary increases, designated payments to Stanton and other key employees as 'personal gifts.' Jacobshagen had never given gifts to Stanton before. After the wage stabilization requirements were relaxed, Stanton's bonus was increased to include the amount previously given as a 'gift.' All parties recognized this increase as additional compensation.

**Procedural History**

The Commissioner of Internal Revenue assessed deficiencies against Stanton, arguing that the payments were taxable income, not gifts. Stanton petitioned the Tax Court for a redetermination of the deficiencies.

**Issue(s)**

Whether payments received by the petitioner from his employer, designated as 'gifts,' are excludable from gross income as tax-free gifts under Section 22(b)(3) of the Internal Revenue Code, or whether they constitute taxable compensation for personal services.

**Holding**

No, because the payments, despite being labeled as gifts, were in reality compensation for services rendered, designed to supplement the employee's income during wage stabilization.

**Court's Reasoning**

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The court emphasized that the intention of the payor and the presence of consideration are key factors in distinguishing gifts from compensation. While the payments were called ‘gifts,’ the court looked at the surrounding circumstances. The court noted that the payments were made because salary increases were restricted, and the subsequent increase in Stanton’s bonus after the restrictions were lifted indicated that the ‘gifts’ were actually compensation. The court cited numerous cases establishing that payments made in recognition of long and faithful service, or in anticipation of future benefits, are generally regarded as taxable compensation. The court directly quoted, “The repeated reference to the payment as a ‘gift’ does not make it one.” The court determined that Jacobshagen’s intent was to increase the bonuses paid to key employees, but designate them as personal gifts to circumvent wage laws. The court reasoned that the close relationship between the payments and Stanton’s employment indicated that they were intended as compensation for services.

**Practical Implications**

This case illustrates that the label attached to a payment is not determinative for tax purposes. Courts will look beyond labels to determine the true nature of the transaction, examining the intent of the payor and the presence of any consideration, direct or indirect. Attorneys advising clients on compensation strategies must consider the substance of the payment, not just its form. Businesses should avoid characterizing payments as gifts if they are truly intended as compensation, as this can lead to adverse tax consequences. Subsequent cases have cited Stanton to support the principle that employer-to-employee payments are presumed to be compensation, and the burden is on the taxpayer to prove otherwise. This case remains relevant in disputes regarding the classification of payments as gifts versus compensation, especially in situations involving employer-employee relationships or where tax avoidance is suspected.

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