4 T.C. 415 (1944)

Income is not constructively received when the right to the funds is disputed or subject to a condition, such as a requirement that accepting a check constitutes full settlement of a disputed claim.

Summary

This case addresses when income is considered received for tax purposes in situations where payment is disputed or conditional. Bones, a cash-basis taxpayer, received a commission check in 1941 but did not deposit it until 1942 because it was offered as full payment for a disputed amount. He also received a promissory note for livestock sold. The Tax Court held that the commission check was not taxable in 1941 because of the dispute, but the note was taxable in 1941 because it had a fair market value and was not subject to restrictions preventing its disposition, even though a subsequent adjustment was made.

Facts

Walter Bones was a branch manager for Altorfer Bros. Co., earning a salary and commissions. In November 1941, Altorfer terminated Bones' employment and sent him a check for commissions, accompanied by a voucher stating it was "in full of all commissions." Bones believed he was owed more and disputed the amount. He did not cash the check. In a separate transaction, Bones sold livestock for a promissory note payable in 1942. The note had full value in 1941, but Bones agreed to an adjustment later. Bones did not report either the commission check or the note as income in 1941.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Bones' 1941 income tax, including the commission check and the promissory note as income. Bones petitioned the Tax Court, arguing the income was taxable in 1942, when he received the cash. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether a commission check received in 1941, but not deposited until 1942 due to a dispute over the amount owed and a condition that acceptance constitutes full payment, is constructively received in 1941.

2. Whether a promissory note received in 1941 for the sale of livestock, payable in 1942 and subject to a possible future adjustment, is taxable income in 1941.

Holding

1. No, because the amount of commissions due was in dispute, and the check was

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offered conditionally as full payment, which Bones did not accept in 1941.

2. Yes, because the note had a fair market value when received in 1941, and Bones' right to use the note was absolute, even though a subsequent adjustment was made in 1942.

Court's Reasoning

Regarding the commission check, the court emphasized that a *bona fide* dispute existed over the amount owed to Bones, and the check was tendered on the condition that it would be accepted as full settlement. Bones had a legal right to refuse the check under those terms, and therefore did not constructively receive the income in 1941. The court cited Treasury Regulations providing that a payment subject to a condition does not constitute constructive receipt. Regarding the promissory note, the court reasoned that Bones received the note without restriction as to its disposition, use, or enjoyment. The court cited precedent including *North American Oil Consolidated v. Burnet*, holding that profit derived without restriction as to its disposition is income, even if there is a contingency that may require him to restore its equivalent in a later year. The oral guarantee about the livestock did not prevent Bones from transferring or disposing of the note.

Practical Implications

This case clarifies that income is not constructively received when a genuine dispute exists regarding the amount owed and acceptance of payment is conditional. Taxpayers can defer income recognition by refusing conditional payments until the conditions are resolved. The case also illustrates that a negotiable promissory note is generally taxable income when received if it has a fair market value, even if subject to potential future adjustments. This case is often cited in disputes over the timing of income recognition. Attorneys should analyze the specific facts to determine if a *bona fide* dispute existed or if the taxpayer had unrestricted control over the funds or instrument in question. Cases subsequent to *Bones* often focus on whether the conditions placed on payment were substantive enough to prevent the taxpayer from having dominion and control.

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