Waters v. Commissioner, 3 T.C. 428 (1944)

Income is not considered constructively received for tax purposes unless it is credited to the taxpayer's account, set apart for them, and made available for withdrawal without substantial limitations or restrictions.

Summary

Waters, the petitioner, argued that $20,000 in extra compensation from his employer, Waters Corporation, for 1940 was constructively received by him in that year, making it taxable then. The Commissioner argued that the income was taxable in 1941, when it was actually received. The Tax Court held that the income was not constructively received in 1940 because it was not credited to Waters' account, set apart for him, or made available without substantial restrictions. No binding corporate action occurred in 1940 to guarantee payment.

Facts

- Waters was to receive extra compensation from Waters Corporation for the year 1940.
- Waters had an agreement with the president of Waters Corporation regarding the amount of the compensation ($20,000).
- No formal corporate action (e.g., board of directors' approval, minutes) was taken in 1940 to authorize or guarantee the payment.
- The funds were not explicitly labeled or set aside for Waters in 1940, despite the corporation having general funds available.
- Book entries reflecting the compensation were not made until after the close of the 1940 tax year.

Procedural History

The Commissioner determined that the $20,000 was taxable income to Waters in 1941. Waters petitioned the Tax Court, arguing that it was constructively received in 1940 and should be taxed then. The Tax Court reviewed the case and ruled in favor of the Commissioner.

Issue(s)

Whether the $20,000 in extra compensation was constructively received by Waters in 1940, making it taxable in that year, despite not being actually received until 1941.

Holding

No, because the income was not credited to Waters' account, set apart for him, or made available for withdrawal without substantial limitations or restrictions during 1940.

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Court’s Reasoning

The court relied on Section 29.42-2 of Regulations 111, which outlines the conditions for constructive receipt. The court found that the facts did not meet these conditions. Specifically, the income was not credited to Waters’ account, nor was it set apart for him in any manner. Although there were general funds on hand, no funds were specifically designated for Waters. The agreement with the president, absent any binding corporate action, did not constitute constructive receipt. The court stated that the income was not “made available to him so that it [could] be drawn at any time, and its receipt brought within his own control and disposition.” The fact that Waters initially treated the income inconsistently in his tax return further weakened his claim.

Practical Implications

This case clarifies the requirements for constructive receipt of income. It emphasizes that a mere agreement to pay compensation is insufficient; there must be a demonstrable action by the payor, such as setting aside funds or crediting an account, that makes the income readily available to the payee without substantial restrictions. Taxpayers cannot merely claim constructive receipt to shift tax liability; they must prove that the funds were truly accessible and under their control. The case serves as a reminder that proper documentation of corporate actions, such as board resolutions, is crucial for establishing constructive receipt. Later cases cite *Waters* to illustrate instances where income was not constructively received because control was not absolute or subject to substantial limitations.

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