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

Income is constructively received when it is credited to a taxpayer's account, set apart for them, and made available for withdrawal without substantial limitations or restrictions.

Summary

Waters, a taxpayer, argued that extra compensation promised by his employer in 1940 should be taxed in that year because it was constructively received, despite actual payment occurring in 1941. The Tax Court disagreed, holding that the compensation wasn't constructively received in 1940. The court emphasized that although there was an agreement with the company president, there was no formal corporate action, the funds were not specifically set aside for the taxpayer, and book entries reflecting the compensation weren't made until after the close of the taxable year. Therefore, the income was taxable in 1941 when it was actually received.

Facts

The Waters Corporation agreed to pay Waters, an employee, $20,000 as extra compensation for 1940.
Though the corporation had general funds, no specific funds were designated or labeled as available for Waters.
While Waters had an agreement with the company president about the amount, there was no evidence of formal corporate approval via board of directors' action.
No minutes or corporate records documented the agreement.
Book entries reflecting the compensation were not made until after the end of 1940.

Procedural History

The Commissioner of Internal Revenue determined that the $20,000 was taxable income to Waters in 1941, the year it was actually received.
Waters petitioned the Tax Court, arguing the amount was constructively received in 1940 and should be taxed in that year.

Issue(s)

Whether the $20,000 in extra compensation was constructively received by Waters in 1940, making it taxable in that year, despite actual payment occurring in 1941.

Holding

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

Court's Reasoning

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The court relied on Section 29.42-2 of Regulations 111, which defines constructive receipt. The court found that the regulation's tests were not met because:
There was no crediting of the income to Waters' account nor was it set apart for him.
No funds were specifically designated as available for Waters to draw upon.
Although there was an agreement with the president, there was no binding corporate action, such as board approval documented in minutes.
These factors meant 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 court noted Waters' inconsistent treatment of the income on his tax return weakened his argument that the funds were actually available to him in 1940. The court stated, "To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition."

Practical Implications

This case clarifies the requirements for constructive receipt, emphasizing that a mere agreement to pay is insufficient. Actual crediting, setting aside, and availability without restriction are necessary.
Taxpayers seeking to demonstrate constructive receipt must show concrete actions by the payor, such as formal authorization, segregation of funds, and notification to the payee.
This decision reinforces the principle that income is generally taxed when actually received unless the taxpayer can demonstrate they had unfettered access to it earlier. Later cases often cite *Waters* when evaluating whether informal promises or agreements constitute constructive receipt absent formal corporate action and segregation of funds.

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