6 T.C. 217 (1946)

A cash basis taxpayer does not constructively receive income when payment is restricted by government regulations, even if the employer is otherwise willing to pay.

Summary

Charles Tufts, a cash basis taxpayer, was authorized a salary increase in 1942 that was not paid due to wartime government regulations. Despite the employer's willingness to pay, the funds were not accrued or credited to Tufts's account that year. When the restrictions were lifted in 1943 and the salary was paid, the Commissioner included the amount in Tufts's 1943 income. The Tax Court upheld the Commissioner's determination, reasoning that Tufts did not constructively receive the income in 1942 because it was not unqualifiedly subject to his demand due to the existing regulations.

Facts

- Tufts was an officer of Allied Chemical & Dye Corporation.
- His annual compensation was increased from $60,000 to $70,000 effective March 1, 1942.
- Tufts only received $60,000 in 1942; the $8,333.34 difference was withheld.
- The employer withheld the additional amount due to regulations issued by the Economic Stabilization Director pursuant to Presidential Order No. 9250, aimed at controlling inflation during wartime.
- The employer was otherwise ready, willing, and able to pay the additional compensation in 1942, but feared penalties for violating the regulations.
- The additional amount was not accrued as a liability on the employer's books nor credited to Tufts's account in 1942.
- The Public Debt Act of April 13, 1943, rescinded the relevant parts of the executive order and regulation, and the employer paid Tufts the $8,333.34 in May 1943.
- Tufts filed an amended return for 1942, reporting the additional amount as income for that year.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Tufts's 1943 income tax, including the $8,333.34 salary payment. Tufts petitioned the Tax Court, arguing the amount should have been included in his 1942 income. The Tax Court upheld the Commissioner's determination.

Issue(s)

1. Whether a cash basis taxpayer constructively received income in 1942 when the income was authorized but not paid due to government regulations, despite

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the employer's willingness to pay.

Holding

1. No, because the income was not unqualifiedly subject to the taxpayer's demand in 1942 due to the existing government regulations preventing its payment.

Court's Reasoning

The Tax Court emphasized that Tufts used the cash receipts and disbursements method of accounting. Under this method, income is recognized when it is actually or constructively received. The court found that the $8,333.34 was not actually received in 1942. Regarding constructive receipt, the court noted that the amount was not unqualifiedly subject to Tufts's demand because government regulations prevented the employer from paying it without risking penalties. The court stated, "The amount in question was not actually received by him in 1942 and it was not unqualifiedly subject to his demand in that year… The evidence shows that the employer was not willing to pay the amount to the petitioner in 1942 and, under such circumstances, the amount was not constructively received by the petitioner in 1942. The reason why the employer was unwilling to pay the amount to the petitioner in 1942 was one over which the petitioner had no control and was sufficient to prevent the amount from becoming taxable income of the petitioner for the year 1942."

Practical Implications

This case clarifies the application of the constructive receipt doctrine for cash basis taxpayers when external restrictions prevent payment of authorized income. It highlights that an employer's willingness to pay is insufficient for constructive receipt if government regulations or other legal constraints prevent the payment. Attorneys should advise clients that income is not constructively received if there are substantial limitations or restrictions on its availability. This ruling remains relevant when analyzing deferred compensation arrangements or situations where regulatory hurdles affect the timing of income recognition. Subsequent cases may distinguish situations where the restriction is self-imposed or easily circumvented, reaffirming that genuine, external limitations are necessary to avoid constructive receipt.

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