***8 T.C. 809 (1947)***

A cash-basis taxpayer does not constructively receive income when its receipt is deferred to a later year under a bona fide, arm's-length agreement with the payor, even if the amount is determined and the payor is willing and able to pay.

**Summary**

Howard Veit, a cash-basis taxpayer, agreed with his employer to defer a portion of his 1940 profit participation, payable in 1941, to 1942. The Tax Court addressed whether this deferred income was constructively received in 1941 and whether income received in 1941 was community or separate property. The court held that the agreement to defer payment was a bona fide business transaction, thus the income was not constructively received in 1941. It also ruled that income received in 1941 for services performed in 1939, while Veit was domiciled in a non-community property state (New York), was his separate property, even though he was domiciled in California (a community property state) when he actually received the payment.

**Facts**

Veit contracted with his employer, M. Lowenstein & Sons, Inc., in 1939 to receive a base salary plus a percentage of net profits. In November 1940, Veit notified the corporation he intended to retire. The corporation requested he stay on in an advisory capacity. As a condition of a new contract, Veit agreed to defer a portion of his profit participation for 1940, otherwise payable in 1941, to quarterly installments in 1942. In 1941, Veit received $55,000 as his profit participation for 1939. He moved to California in late 1940.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Veit's 1941 income tax, arguing that he constructively received the deferred income in 1941 and that all income received in 1941 was community property. Veit petitioned the Tax Court for a redetermination. The Tax Court ruled in favor of Veit on the constructive receipt issue, but sided with the Commissioner on the community property issue.

**Issue(s)**

1. Whether a cash-basis taxpayer constructively received income in a year when he did not have the right to receive it and did not in fact receive it, due to a deferred payment agreement.

2. Whether income received by a taxpayer while residing in a community property jurisdiction is community property or separate property, where the source of the income was a contract executed while the taxpayer was a resident of a non-community property state.

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## Holding

1. No, because the agreement to defer the payment was a bona fide business transaction at arm's length, and the taxpayer did not have the right to receive the income in 1941.

2. Separate property, because the right to the additional compensation became vested while the taxpayer was domiciled in a non-community property state (New York).

## Court's Reasoning

The court reasoned that the agreement to defer payment of the $87,076.40 was an "arm's length business transaction entered into by petitioner and the corporation which was regarded as mutually profitable to both." The court relied on *Kay Kimbell, 41 B.T.A. 940*, where a similar deferral agreement was upheld. The court distinguished cases cited by the Commissioner, finding them factually dissimilar. Regarding the community property issue, the court applied California law, which holds that property acquired in another state that was separate property remains separate property after it is brought into California. The court distinguished *Fooshe v. Commissioner, 132 F.2d 686*, because in *Fooshe*, the income was deemed compensation for services performed in the community property state (California), whereas, in *Veit*, the income was for services completed in New York.

## Practical Implications

*Veit* provides a clear example of how a taxpayer on the cash method of accounting can defer income recognition by entering into a bona fide agreement to delay payment. The agreement must be made before the income is earned or readily available. This case is frequently cited for the principle that a taxpayer can arrange their affairs to minimize taxes, provided the arrangement is not a mere sham. The case also reinforces the principle of separate property maintaining its character even after the recipient moves to a community property state. Subsequent cases have distinguished *Veit* where the deferral agreement lacked economic substance or was entered into after the income was earned.

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