Knapp v. Commissioner, 12 T.C. 1062 (1949)

The doctrine of constructive receipt dictates that income is taxable when it is unconditionally available to a taxpayer, even if not physically received, thus preventing taxpayers from manipulating the timing of income recognition to avoid or defer tax liability.

Summary

The case concerns a taxpayer, Knapp, who received a settlement from his former employer, Interstate, for stock and bonus claims. The IRS included the settlement proceeds in Knapp's gross income for the year 1946, even though a portion was paid in 1947. The Tax Court found that a portion of the settlement was constructively received in 1946 because Interstate was ready, willing, and able to pay the full amount at the end of 1946, and the delay in payment was solely at Knapp's counsel's request. The court focused on whether the income was unqualifiedly available to the taxpayer.

Facts

Knapp reached a settlement with Interstate in late December 1946, resolving claims for a bonus and his stock. Interstate was prepared to pay the full settlement amount at that time. However, a portion of the payment ($13,034.29) was delayed until January 3, 1947, at the request of Knapp's attorney. Knapp reported his income on a cash basis. The IRS determined that the delayed portion should have been included in Knapp's 1946 income under the doctrine of constructive receipt. Knapp contested this, arguing that he hadn't actually received the income until 1947.

Procedural History

The Commissioner of Internal Revenue determined a tax deficiency against Knapp for the year 1946, based on the inclusion of the delayed portion of the settlement. Knapp petitioned the Tax Court to challenge this determination.

Issue(s)

1. Whether Knapp constructively received the delayed portion of the settlement in 1946, even though he did not receive the payment until 1947.

Holding

1. Yes, because the full settlement amount was available to Knapp in 1946, and the delay in payment was at his counsel's request, making the income constructively received in 1946.

Court's Reasoning

The court applied the doctrine of constructive receipt. The court stated that for taxpayers on a cash basis of accounting, income is generally recognized only when actually received. However, the court clarified that an exception to this rule exists when income is constructively received. Constructive receipt occurs when income is unqualifiedly available to the taxpayer, regardless of whether the taxpayer actually takes possession of it. The court cited the Treasury Regulations, which state that a taxpayer cannot avoid tax by turning their back on available income. The court emphasized that Interstate was ready, able, and willing to pay the full settlement amount in 1946. There was no evidence to suggest that Interstate would have benefited from delaying the payment. The court determined that the funds were available to Knapp, and his attorney's request for delay did not change the fact that he had control over the funds. The court explicitly held that postponing payment until 1947 occurred solely at the request of Knapp's counsel. This was a critical factor in finding constructive receipt.

Practical Implications

This case underscores the importance of understanding the constructive receipt doctrine in tax planning. Attorneys and taxpayers should consider the following implications:

- **Timing is crucial:** Taxpayers must consider not only when they receive income but also when income becomes available to them.
- **Control matters:** If a taxpayer has the right to receive income and can demand it, they are likely to be considered in constructive receipt, even if they choose to delay actual receipt.
- **Document everything:** The court's decision relied heavily on the fact that the delay in payment was requested by Knapp's attorney. Evidence, like correspondence and meeting notes, about the timing of the settlement and who initiated any delay, can be vital in proving when income was available.
- **Impact on negotiations:** When negotiating settlements or contracts, taxpayers should be aware of how the timing of payments might trigger constructive receipt and impact their tax liabilities.
- **Distinguished from other cases:** This case can be distinguished from situations where there are genuine restrictions on the availability of funds (e.g., escrow accounts, substantial limitations on the taxpayer's ability to obtain the funds) that would prevent constructive receipt.

