27 T.C. 65 (1956)</p>

Dividends held in escrow pending resolution of a stock ownership dispute are taxable to the rightful owner in the year the funds are released, not in the years the dividends were declared or held by the court.

Summary</p>

In McRitchie v. Commissioner, the U.S. Tax Court addressed when dividends, subject to a stock ownership dispute and held in a court registry, become taxable income. The court held that the dividends were taxable in 1951, when the funds were released to the rightful owner, and not in the years the dividends were declared (1948-1950). The court reasoned that neither the corporation nor the court acted as a fiduciary accumulating income for an unascertained person under the Internal Revenue Code. The decision underscores the importance of actual receipt and control of funds for income tax liability, especially in situations involving legal disputes.

Facts</p>

Lee McRitchie purchased stock in 1939. A dispute over ownership arose in 1948 with William Syms. The corporation, Broward County Kennel Club, declared dividends in 1948, 1949, and 1950, but withheld payment due to the ownership dispute. In 1949, Broward initiated an interpleader action and paid the 1948 and 1949 dividends into the court's registry. In 1950, the corporation deposited the 1950 dividends with the court. Litigation concluded in 1951 in McRitchie's favor, and the court released the funds to him. The IRS determined the dividends were taxable in 1951, the year of receipt.

Procedural History</p>

The case began with the IRS determining a deficiency in McRitchie's 1951 income tax return, attributing the dividends declared in 1948-1950 to that year. McRitchie challenged the IRS determination in the U.S. Tax Court.

Issue(s)</p>

Whether the dividends declared in 1948, 1949, and 1950, but held in the registry of the court, were taxable to the McRitchies in 1951 when received, or in the years the dividends were declared?

Holding</p>

Yes, the dividends were taxable to the McRitchies in 1951 because the dividends were income to the McRitchies in the year they were received. The court found that neither Broward nor the court was acting as a fiduciary under the relevant tax code sections.

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Court’s Reasoning</p>

The court applied Internal Revenue Code of 1939, sections 161 and 3797, which addressed taxation of income of estates and trusts. The court determined that the dividends were not income accumulated in trust for the benefit of unascertained persons, as described by the code, because the dispute involved two identified persons, McRitchie and Syms. The court cited the definition of a “trust” as a fiduciary. The court also found that the corporation and the court did not function as fiduciaries, nor did they accumulate income for an unascertained person. Broward, at most, was a debtor. The court noted that the court was a stakeholder, holding money without the usual duties of a trustee.

The court referenced other cases, like De Brabant v. Commissioner, to support its definition of unascertained persons. The court found that the dividend income was not taxable to the McRitchies until 1951, the year they received it.

Practical Implications</p>

This case is crucial for understanding when income is considered received for tax purposes, particularly when legal disputes delay access to funds. Lawyers should advise clients that income is generally taxed when it is actually received, and not when it is earned, or when the right to the income is established. The decision highlights that if funds are held by a court or other entity pending the resolution of a legal dispute, the income is taxable in the year the funds are distributed. This principle is applicable in various scenarios, including escrow accounts, litigation settlements, and situations involving contested ownership of assets. The case reinforces the importance of the concept of constructive receipt. Later cases involving constructive receipt continue to cite McRitchie, emphasizing its ongoing significance.

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