Zeltzerman v. Commissioner, 34 T.C. 88 (1960)

A taxpayer constructively receives income, and it is therefore taxable, when he has the unfettered right to receive it, even if he chooses to have it paid to a third party on his behalf.

Summary

The case involves a physician, Zeltzerman, who provided services to two hospitals. He arranged for the hospitals to purchase annuity contracts for him, using a percentage of his earnings as premiums. The Tax Court held that Zeltzerman constructively received the income used to purchase the annuities, making the amounts taxable in the years the annuities were purchased, not when he received payments under the annuity contracts. The court found that he had the right to receive the money in cash and that the hospitals were acting at his direction when purchasing the annuities. Zeltzerman argued he did not receive income until the annuity payments commenced. The Court distinguished the case from other instances of employer-purchased annuities and emphasized the lack of restrictions on Zeltzerman's ability to receive his compensation in cash.

Facts

Dr. Morris Zeltzerman, a radiologist, provided services to two hospitals. Under oral agreements, he received a percentage of the X-ray charges as compensation. In 1954, Zeltzerman learned of a plan to defer tax on income by using annuities. He discussed this with the hospitals, which agreed to purchase annuity contracts for him using a portion of his compensation. The hospitals established savings accounts and deposited Zeltzerman's percentage-based compensation into these accounts. The hospitals then used funds from these accounts to purchase annuity contracts for Zeltzerman. Zeltzerman also received some cash payments from the hospitals. Zeltzerman did not initially report the annuity purchases as income. The IRS determined deficiencies in Zeltzerman's income tax, claiming the amounts used to purchase the annuities were taxable income in the years of purchase.

Procedural History

The Commissioner of Internal Revenue issued a notice of deficiency to Zeltzerman, asserting that the amounts used to purchase the annuity contracts constituted taxable income. Zeltzerman petitioned the Tax Court to challenge the deficiency. The Tax Court heard the case and ruled in favor of the Commissioner, finding that Zeltzerman had constructively received the income used to purchase the annuities. The court's decision resulted in a finding for the respondent.

Issue(s)

1. Whether the amounts expended by the hospitals to purchase annuity contracts for Zeltzerman should be included in his gross income for the years the contracts were

purchased?

2. If Zeltzerman was an employee, whether the purchase of the annuities by the hospitals qualified for preferential tax treatment under Section 403(a) of the Internal Revenue Code?

Holding

1. Yes, because Zeltzerman had constructive receipt of the income used to purchase the annuity contracts.

2. No, because the court found that the purchase of the annuities by the hospitals was, in effect, at Zeltzerman's direction.

Court's Reasoning

The court focused on the doctrine of constructive receipt. This doctrine provides that income is taxable to a taxpayer when it is available to him without substantial limitation or restriction, even if he does not actually receive it. The court found that Zeltzerman had the right to receive his compensation in cash based on the existing oral agreements with the hospitals. There was no binding agreement to change this pre-existing relationship. The hospitals were merely acting at his direction by purchasing the annuity contracts, which, in effect, was the same as if he had received the cash and purchased the annuities himself. Thus, the amounts used to purchase the annuities were constructively received and taxable to Zeltzerman in the years of the purchases. The court distinguished this case from *Commissioner v. Oates*, where a binding agreement altered the timing of income receipt through an irrevocable agreement, which was not found in this case. The court also held it was unnecessary to address whether Zeltzerman was an employee within the meaning of section 403(a), because even if he was, the application of this section hinges on whether the cost was incurred by the employer rather than Zeltzerman's direction.

Practical Implications

This case highlights the importance of the constructive receipt doctrine in tax law. Attorneys and taxpayers must be aware that income is taxable when it is available, even if not physically received. The court emphasizes substance over form; even though the hospitals purchased the annuities, the economic reality was that Zeltzerman controlled the disposition of his compensation. This means that taxpayers cannot avoid tax liability simply by instructing a third party to receive income on their behalf if they have the right to take the income in cash. This case has implications for retirement planning, deferred compensation arrangements, and any situation where a taxpayer may have control over when and how they receive their income. The analysis in *Zeltzerman* continues to be relevant when considering arrangements such as salary reductions to fund employer-sponsored annuity plans. It is critical to consider the existence of any binding agreement that would prevent the taxpayer from receiving income directly.

