F. D. Bissett & Son, Inc. v. Commissioner, 56 T. C. 453 (1971)

Interest is constructively received when it is made available to the recipient and subject to their demand, even if not credited to their account until later.

Summary

F. D. Bissett & Son, Inc. deducted interest accrued on debentures held by related parties in 1965-1967. The Commissioner disallowed these deductions under IRC §267(a)(2), which disallows deductions for unpaid interest to related parties unless the interest is paid and included in the recipient's income within 2. 5 months after the tax year. The Tax Court held that the interest was constructively received by the debenture holders within the statutory period because it was available to them upon demand, thus allowing the deductions. The court emphasized that constructive receipt occurs when income is available and subject to the recipient's demand, not necessarily when it is credited to their account.

Facts

F. D. Bissett & Son, Inc. issued debentures to its founder, F. D. Bissett, which were later distributed among his family members. The company accrued interest on these debentures annually, but the payments were made or credited to the holders' accounts at various times. The company's bookkeeper, with full authority, calculated the interest due each year and attached memoranda to the company's ledger detailing the amounts owed to each holder. The interest was either paid by check upon request or credited to personal accounts at the end of the year or early the following year, as per the holders' preferences.

Procedural History

The Commissioner disallowed the interest deductions claimed by F. D. Bissett & Son, Inc. for the years 1965-1967, asserting that the interest was not paid within the statutory period required by IRC §267(a)(2). The company petitioned the Tax Court for relief, arguing that the interest was constructively received by the debenture holders within the required timeframe.

Issue(s)

1. Whether the interest accrued by F. D. Bissett & Son, Inc. on its debentures was constructively received by the debenture holders within the period consisting of the taxable year and 2. 5 months thereafter, as required by IRC §267(a)(2)(A).

Holding

1. Yes, because the interest income was made available to the debenture holders within the statutory period and was subject to their unqualified demand, satisfying the constructive receipt doctrine.

Court's Reasoning

The court applied the constructive receipt doctrine, which states that income is constructively received when it is credited to an account, set apart for the recipient, or otherwise made available so that they may draw upon it at any time. The court noted that the company's bookkeeper had the authority to pay the interest at any time after it became due, and the debenture holders could request payment whenever they wanted. The court rejected the Commissioner's argument that book entries crediting the interest were necessary for constructive receipt, stating that the interest was available to the holders upon demand, which satisfied the constructive receipt requirement. The court also considered that the debenture holders included the interest in their income tax returns for the following years, although this was not conclusive. The court's decision was based on the principle that the right to receive income, not merely the power, determines constructive receipt.

Practical Implications

This decision clarifies that for purposes of IRC §267(a)(2), constructive receipt of interest can occur without formal book entries, as long as the income is available to the recipient upon demand. This ruling impacts how companies with related-party transactions should structure their accounting and payment practices to ensure compliance with tax regulations. It also affects legal practice in tax law, emphasizing the importance of understanding the constructive receipt doctrine in related-party transactions. Subsequent cases have cited this decision when analyzing the timing of income recognition and the application of IRC §267. Businesses should ensure that interest payments to related parties are made available within the statutory period to avoid disallowance of deductions.

