Martin v. Commissioner, 93 T. C. 623 (1989)

An employee is not in constructive receipt of deferred compensation benefits if the right to receive those benefits is subject to substantial limitations or restrictions.

Summary

Martin and Bick, former employees of Koch Industries, elected to receive their deferred compensation benefits under a new shadow stock plan in installments rather than a lump sum. The IRS argued they were in constructive receipt of the entire benefit upon termination due to the availability of a lump sum. The Tax Court held that the benefits were not constructively received because the employees had to forfeit future participation rights and the benefits were not yet due or fully ascertainable. This ruling clarifies that constructive receipt does not apply when substantial limitations or restrictions exist on the employee's right to receive deferred compensation.

Facts

Martin and Bick were long-term employees of Koch Industries who participated in the company's old deferred compensation plan. In 1981, Koch introduced a new shadow stock plan, allowing participants to elect either a lump-sum payment or 10 annual installments upon termination. Both Martin and Bick elected installments. Martin's employment was terminated involuntarily in August 1981, and Bick resigned in August 1981. The IRS assessed deficiencies, claiming the entire benefit was constructively received in 1981 due to the lump-sum option.

Procedural History

The Tax Court consolidated the cases of Martin and Bick. The IRS determined deficiencies in their 1981 federal income taxes, asserting constructive receipt of their deferred compensation benefits. The petitioners challenged these deficiencies, arguing they were not in constructive receipt until they actually received the installments.

Issue(s)

1. Whether Martin and Bick were in constructive receipt of their entire shadow stock benefits in 1981 when they could have elected a lump-sum distribution.
2. Whether the election to receive benefits in installments precluded constructive receipt of the entire benefit in 1981.

Holding

1. No, because the benefits were not yet due or fully ascertainable, and petitioners had to forfeit future participation rights to receive any payment.
2. No, because the election to receive installments was made before the benefits

became due, and the right to receive income was subject to substantial limitations and restrictions.

Court's Reasoning

The court applied the constructive receipt doctrine, which states that income is constructively received when it is credited to the taxpayer's account, set apart, or otherwise made available without substantial limitations or restrictions. The court found that Martin and Bick's rights under the plan were unsecured and unfunded, similar to those of general creditors. The election to receive installments was made before the benefits became due or fully ascertainable. The court emphasized that petitioners had to forfeit future participation in Koch's profits and equity growth to receive any payment, which constituted a substantial limitation or restriction. The court distinguished this case from others where benefits were due or fully ascertainable at the time of election. The court also noted that interest only accrued on the unpaid balance after the first installment, further supporting the lack of constructive receipt in 1981.

Practical Implications

This decision clarifies that the availability of a lump-sum option in a deferred compensation plan does not automatically result in constructive receipt if the employee's right to receive the benefits is subject to substantial limitations or restrictions. Practitioners should advise clients to carefully structure deferred compensation plans to avoid constructive receipt, ensuring that elections are made before benefits are due and that participants must forfeit significant rights to receive payments. This ruling may encourage employers to design plans that allow for flexibility in payment options without triggering immediate tax consequences. Subsequent cases, such as Veit v. Commissioner and Robinson v. Commissioner, have cited Martin in upholding the principle that constructive receipt does not apply to deferred compensation plans with substantial restrictions on the right to receive benefits.

