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Constructive Receipt of Income Baxter v. Commissioner

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CONSTRUCTIVE RECEIPT OF INCOME
BAXTER v. COMMISSIONER

In *Baxter v. Commissioner*,[1] the court decided whether taxpayer Baxter had constructively received $13,095 of commissions he had earned in 1978. Baxter, a cash basis taxpayer, received a check in the mail for these commissions in early 1979. The check was dated December 30, 1978.

Treasury Regulation Section 1.451-2(a) controls and provides, in part, that a taxpayer constructively receives income when it is otherwise made available to draw upon at any time, even though it is not reduced to the taxpayer's possession. However, there is no constructive receipt if "taxpayer's control of its receipt is subject to substantial limitations or restrictions."[2]

The tax court held that these commissions were income to Baxter in 1978, relying on Baxter's own statement that he could have picked up the check on December 30.[3] The Court of Appeals reversed, stating that there were substantial restrictions preventing Baxter's necessary exercise of control.[4] The court relied on Baxter's hypothetical at trial: he could have driven forty miles on Saturday, December 30, to collect his check, and then driven forty miles home, but only in futility, as he would be unable to receive credit for the check at a bank until January 2, 1979. The court of appeals concluded that such an eighty-mile round trip in futility was an "effective barrier to Baxter's asserting control over the check."[5]

The Baxter court noted that the decision in *McEuen v. Commissioner*[6] suggested that geography does not create a barrier to constructive receipt. The *McEuen* court stated that if the issue was the actual receipt of income, geography would be important, but continued to say that "it is difficult to see how, upon the question of constructive receipt, i.e., the availability of the payment, the geography or distance is important in law."[7]

Historically, limitations that prevented constructive receipt of income arose from the form of, or a technical requirement in, the compensation plan. For example, there was no constructive receipt of income where the taxpayer's escrowed securities, held by a sequestrator, accumulated interest and dividends. These amounts were not paid out due to substantial limitations placed on them by a state sequestration statute.[8] There was no constructive receipt of income to a cash-basis shareholder when a dividend was declared payable by the corporation on Decem-

[1] Baxter v. Commissioner, 816 F.2d 493 (9th Cir. 1987), *rev'g in part* 54 T.C.M. (P.H.) ¶ 85,378 (1985).

[2] Treas. Reg. § 1.451-2(a) (19).

[3] *Baxter*, 54 T.C.M. (P.H.) ¶ 85,378 at p. 1667.

[4] *Baxter*, 816 F.2d at 495.

[5] *Id.*

[6] 196 F.2d 127 (5th Cir. 1952).

[7] *Id.* at 130.

[8] Stone v. Commissioner, 53 T.C.M. (P.H.) ¶ 84,187 (1984).

ber 31 and the corporation mailed the checks out so that the shareholders did not receive them until January the following year.[9] There also was no constructive receipt of income to a cash-basis farmer who had to insure his potatotes before the purchaser would give him his check.[10] The court held that the insurance requirement was a condition precedent that was a substantial restriction to receive the income.[11] Also, bonuses were not constructively received by corporate officers where the funds were not available to them on an unrestricted basis.[12] The corporation first limited the payment to the following year, then conditioned the payment upon the improvement of the financial condition of the corporation, and then further restricted the bonuses by granting authority to a third party to determine whether such an improvement had been accomplished.

Unlike these traditional restrictions and limitations that are put on the receipt of income by another party or the circumstances of a transaction, the *Baxter* court identified untraditional restrictions based on geographic difficulties. Such physical restrictions, such as the unavailability of a bank, had previously been discounted as "substantial" enough to prevent constructive receipt of income.[13]

In Rev. Rul. 76-3,[14] a cash basis taxpayer was sent his severance pay by certified mail. Taxpayer was not at home when the Postal Service attempted delivery on December 31, 1974. The mailman left a Notice of Attempted Delivery informing taxpayer that he could pick up the check after 3 p.m. on that day. By the time taxpayer returned home that night, the post office was closed and he was therefore unable to get actual delivery until January 2, 1975. The ruling cited Treas. Reg. Section 1.451-2(a), and held that this amount was includible for tax year 1974, as it was constructively received.[15]

The ruling, in its analysis, distinguished the situation from *Avery v. Commissioner*[16] on which the *Baxter* court relied. *Avery* held that dividend checks mailed

[9] Treas. Reg. § 1.451-2(b) (19).

[10] Patterson v. Commissioner, 510 F.2d 48 (9th Cir. 1975).

[11] *Id.* at 51.

[12] R.J. Tricon Co., Inc. v. United States, 572 F. Supp. 1050 (E.D. La. 1983).

[13] Rev. Rul. 68-126, 1968-1 C.B. 194. "[I]n order for income to be constructively received it must be made available to the taxpayer for his immediate use and enjoyment. If a retirement check is placed in the mail before the year's end, but it not received by the taxpayer until the following year, the amount of the check is includable in gross income for the taxable year in which it was actually received, except where the taxpayer could have received the check in the year before it was actually delivered to him by appearing in person and claiming it. In such circumstances, the income is constructively received in the year preceding the year of actual receipt." Rev. Rul. 68-126, 1968-1 C.B. at 195.

[14] Rev. Rul. 76-3, 1976 C.B. 114.

[15] Rev. Rul. 76-3, 1976-1 C.B. at 115. "[T]he check was available to the taxpayer in the taxable year preceding the year in which the check was actually received. The individual's absence from home when delivery was attempted is not a limitation or restriction on receipt of the payment on that day and thus, does not bar constructive receipt of payment. Moreover, the fact that the Post Office was closed before the individual read the notice advising that certified mail could be obtained there did not prevent constructive receipt. Accordingly, the severance pay is includible in the individual's gross income for the year ending December 31, 1974." *Id.* at 115.

[16] Avery v. Commissioner, 292 U.S. 210 (1934).

out by a corporation on December 31 to its shareholders so that they could not obtain possession of them until January were not includible in the gross income of the shareholders in the previous year.[17] However, *Avery* noted that there was nothing to show that the shareholders could have obtained these dividends on December 31.[18] Comparatively, in *Baxter*, the taxpayer could have received his check if he would have appeared in person to pick it up.

The various revenue rulings, along with holding in *Avery*, emphasize that income is constructively received if the taxpayer *could have* obtained possession of the income. If the taxpayer decides not to avail himself of receiving it, this will not change the fact that he has received it for tax purposes. A taxpayer may not arbitrarily select the year in which a given item of income is to be reported.[19] If the income is available without substantial limitation, and the taxpayer fails to receive it due to his own volition, then it will be considered constructively received by the taxpayer during the year available.[20]

In *Baxter*, the payor of the commissions due made them available to Baxter in 1978. Had Baxter chosen to pick them up on December 30, the income would have been actually received and undoubtedly included in gross income. However, Baxter chose to delay his receipt of these available commissions until 1979, effectively postponing their tax treatment to a subsequent year — an act prohibited in the Circuit due to *Oliver*.[21]

The Baxter case seems to present an expansive view of the term "substantial restrictions or limitations," to the point where the mere inconvenience of driving to pick an otherwise available check can be sufficient enough to prevent the constructive receipt of income. Such an interpretation does not seem consistent with the authorities discussed herein, and it will be interesting to see if *Baxter* represents a new advantage to taxpayers in helping them to avoid the constructive receipt of income.

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[17] *Id.* at 215.

[18] *Id.*

[19] Oliver v. United States, 193 F. Supp. 930 (E.D. Ark., 1961).

[20] *Id.* at 933.

[21] Although the holding in *Oliver* is not binding in the 9th Circuit, one should note that a case with a holding similar to that in *Oliver* does exist in the 9th Circuit. In Bennett v. United States, 293 F.2d 323, 326 (9th Cir. 1961), the court held that "if the taxpayer is free to enjoy the income, it is treated as received and is taxed to him whether he sees fit to enjoy it or not."