

The IRS Endorses Attorneys' Fee Deferral

The Childs Case Cited

In a July 5, 2001 Field Service Memorandum, the Internal Revenue Service cited the *Childs* case (*Richard A. Childs, et al., v. Commissioner of Internal Revenue*, 1994) in support of a no constructive receipt finding. Although the FSM did not deal with attorneys' fees, the fact that the IRS now favorably cites this ruling clearly indicates that attorneys' fee structures will not be challenged by the IRS.

From page five of the memorandum:

"Constructive Receipt

Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Treas. Reg. § 1.451-2(a).

Thus, taxable income of a cash basis taxpayer is money or other property that is subject to taxpayer's unfettered will and control; that the taxpayer is free to enjoy at his own option; that exists and is available to taxpayer; and that except for taxpayer's own volition, can immediately be reduced to his possession. The doctrine prevents a taxpayer from deferring income when earlier receipt is prevented solely by taxpayer's own will. *Gertzman*, supra at 3-22. On the other hand, where attorneys entered into a structured settlement which called for deferred payments of their fee, and the settlement was entered into prior to obtaining an unconditional right to compensation for their legal services, the court held that they had not constructively received income upon the purchase of the annuity contracts meant to provide payment for the legal services fee. *Childs v. Commissioner*, 103 T.C. 634 (1994). See also *Reed v. Commissioner*, 723 F.2d 138, 1st Cir., (1983) (Sale proceeds deposited into escrow account; seller did not constructively receive income where the account set up by agreement between parties entered into before seller had any right to the funds; and seller was not entitled to any economic benefits prior to scheduled disbursement.)

These cases demonstrate that if the income is not unqualifiedly subject to the taxpayer's demand, it has not been constructively received."