

The Constructive Receipt Surprise

by Richard G. Halpern

Confused about constructive receipt? If so, you have a lot of company in the plaintiff's bar. Constructive receipt is the tax law doctrine that says that income is taxed to you before it's actually received if it is credited to you, set aside for you, or made available to you so that you can draw on it at any time. However, there is no constructive receipt of income if your control of it is subject to substantial limitations or restrictions. [Treas. Reg. 1.451-2(a)]

This rule has special significance in a structured settlement. If your client settles for a lump sum and provides a release, then later wants to structure, it is too late. Your client will have a tax-free receipt of the present value of the U.S. government bond or annuity that funds the settlement, but any interest earned on the bond or annuity is going to be taxable to the plaintiff. A similar result would follow if you obtained a final judgment with all appeal opportunities expired or exhausted, and then tried to structure. Again, constructive receipt will have already occurred. But for the plaintiff's attorney who plans ahead, there is a great deal of time to maneuver within the negotiation process before constructive receipt becomes an issue. If you merely discuss a structure in negotiations, constructive receipt does not apply. If you know how much the defendant will spend on the structure or the cost and present value of the bond or annuity being used to fund the settlement, there is no constructive receipt. The IRS has made this clear. [PLR 8333035 and PLR 9017011] As long as you are still negotiating, constructive receipt will not apply. The key to the settlement process is your agreement to release the defendant in exchange for an acceptable settlement. As you discuss the amount and timing of the payments to be structured, as well as whether U.S. Government Treasury Bonds or annuities will be used to fund the structure, you are still negotiating. A mutually acceptable settlement is a condition of the release agreement; without both the settlement and the release, no final agreement has been reached. There is no constructive receipt. As a trial attorney, you know that representing your client in settlement negotiations requires you to maintain as much control over the situation as you possibly can. You have every right in the course of negotiations -- and perhaps the responsibility -- to demand not only the amount you want to receive for your clients, but also the specific settlement product that ensures your client's protection, and even a specific settlement broker that you can be certain will keep your interests and your client's interests in proper focus.

It is critical that you have the structure, broker, and tax consequences that are in your client's best interests before the release that triggers constructive receipt.