

## **Background Information on Constructive Receipt Federal Income Taxation Problem**

1. Tax Law Doctrine of “Constructive Receipt”. “Constructive receipt” is a federal tax law principle that relates to the timing of when compensation or other items of value are considered to have become income subject to taxation. The doctrine holds that a person has income subject to taxation at a time before it is actually paid or received if the income is credited to the taxpayer, set aside for the taxpayer, or made available to the taxpayer so that the person can draw on the amount at any time and the taxpayer’s control of the amount is not subject to substantial limitations or restrictions (see Treasury Regulation 1.451-2(a)).

Thus, under the doctrine, when a taxpayer has effective control of money or an asset payable to the person, even though the payment has not actually been made, the taxpayer will be treated as though the income was received and federal income tax will be payable.

2. Constructive Receipt of Teacher Severance Pay Plan Accruals Problem. Severance pay plans are common among school districts and other educational employers, especially for teachers. These severance pay plans vary in their benefit structure, with some severance pay plans providing a specified dollar amount, some allowing a cash-out of all or a portion of unused sick leave accruals, and some providing a declining amount as the teacher approaches age 65 or other recognized target retirement age.

For whatever reason, the federal Internal Revenue Service reportedly has targeted Minnesota school districts, Minnesota teachers, and their severance pay plans for special tax audit attention. The federal Internal Revenue Service apparently has decided that severance pay plans that provide a specific dollar amount will constitute constructive receipt income for the teacher for the year in which the teacher attains the earliest age for receipt of the severance pay, even if the teacher does not separate from active service, and will require them to pay income taxes on that amount at that time.