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# THE B&B ALERT

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## ***CONSTRUCTIVE RECEIPT*** ***By Thomas D. Begley, Jr., Esquire***

Personal injury attorneys should avoid receiving payment from the defendant or the defendant's insurer into the attorney's trust account for any funds that are intended to be placed into a special needs trust for the benefit of the plaintiff. Payment of funds by the defendant to the plaintiff's personal injury attorney constitutes constructive receipt by the person with a disability. Therefore, checks from the defendant should be made payable directly to the trustee of the special needs trust. Payments from the structure should also be made payable directly to the trustee of the special needs trust. Constructive receipt by the beneficiary will cause a loss of public benefits because the SSI income and resource rules have been violated, if the funds are held by the personal injury attorney for a long period of time. If the funds are disbursed by the personal injury attorney in the month received, there is an overpayment of one month and SSI would have to be repaid.

In situations where there is a lump sum settlement and the defendant insists on paying the plaintiff's attorney quickly, the court may order that the monies be held in the attorney's trust account subject to conditions, such as satisfaction of Medicare and Medicaid liens. This should avoid a constructive receipt argument by SSA. The trial attorney then makes the plaintiff's check payable to the trustee of the special needs trust at such time as all of the conditions imposed by the court order are satisfied.

There are two unpleasant consequences that can flow from constructive receipt:

- *Public benefits eligibility.* If an SSI recipient receives income during a month, it may result in an overpayment. However, if the income is from a personal injury, inheritance or equitable distribution, then an argument can be made that the income is infrequent and irregular and should not be counted.<sup>[1]</sup> If the funds are still available on the first day of

<sup>[1]</sup> POMS S.I. 00810.015.A.3. and POMS S.I. 00810.001.

the following month, they become a resource.<sup>[2]</sup> Not all of an individual's assets are resources. A resource is defined as cash and any other personal property, that an individual owns; has a right, authority, or power to convert to cash (if not already cash); and *is not legally restricted from using for his support and maintenance.*<sup>[3]</sup> If settlement funds are held in a lawyer's trust account, they are constructively received by the individual, but if there is a restriction on the use of those funds not related to the support and maintenance of the individual, they will not be counted as a resource. Therefore, unless there is a legal restriction to making the funds available for the individual's support and maintenance, the funds held in the attorney's trust account will be considered a countable resource available to the SSI recipient. Examples of what might constitute a legal restriction include the following:

- Allocation among claimants as yet to be determined. The lawyer must make a determination within a reasonable period of time.
  - Determination of liens amounts and their compromise.
  - Determination of amount of attorneys' fees and costs to be paid, but this is typically set forth in a contingency fee agreement and only benefits the claimant to the extent the personal injury lawyer is contemplating reducing his fees.
  - The need to have a guardian of the estate or a conservator appointed, but the lawyer must act within a reasonable amount of time.
  - The settlement agreement that is contingent upon court approval, which is typically the case where there is a minor or incompetent adult.
- *Taxation.* From a tax standpoint, the concept of constructive receipt analyses the timing of recognizing income with an eye toward preventing taxpayers from manipulating which tax years they will report income. Generally, "the amount of any item of gross income shall be included in the gross income for the taxable year in which it is received by the taxpayer, unless under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period."<sup>[4]</sup> Therefore, if a structured settlement is constructively received, the income generated on the entire value of the settlement will be currently taxed. Constructive receipt is defined as "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."<sup>[5]</sup>

Disclosure by a defendant of the cost or present value of an annuity to be purchased to fund its monthly settlement obligation will not cause constructive receipt of the present value of the amount invested in the annuity.<sup>[6]</sup> What constitutes a substantial limitation is decided on a case-by-case basis. Taxable receipt occurs

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<sup>[2]</sup> 20 C.F.R. §416.1208(a).

<sup>[3]</sup> POMS S.I. 01110.100.B.1.

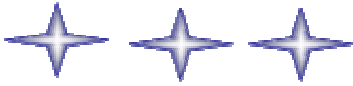
<sup>[4]</sup> I.R.C. §451(a).

<sup>[5]</sup> Treas. Reg. 1.451-2a.

<sup>[6]</sup> PLR 8333035 (May 16, 1983).

when funds are received by the payee's agent (i.e., plaintiff's attorney). In the case of *Gale v. Commission*,<sup>[7]</sup> a check was placed in an attorney's escrow account pending resolution of disputes over attorney's fees and the amount owed to the taxpayer's ex-wife. The court held that this constituted constructive receipt, because any restriction was placed on the account only by the taxpayer's creditors and that did not delay petitioner's receipt of income for income tax purposes.

In another case it was held that funds held in escrow pending a court order are subject to substantial limitations.<sup>[8]</sup>



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## Speakers

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## Begley & Bookbinder

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The Firm provides services in connection with protecting assets from nursing home costs, Medicaid applications, Estate Planning and Estate Administration, Special Needs Planning and Guardianships. If you have a legal problem in one of these areas of law, contact Begley & Bookbinder at 800-533-7227.

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<sup>[7]</sup> Lee Gale v. Commissioner, TC Memo 2002-54, 83 ICM 1270 (Feb. 27, 2002).

<sup>[8]</sup> E.J. Murray v. Commr., 21 TC 1049 (Dec. 20, 1954).

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