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Kanye West Could Still Get $1 Billion Tax Free

Kanye West wanted Facebook's Mark Zuckerberg to pony up the $1 billion Mr. West says he needs. But he apparently isn't out for charity or small handouts. In fact, Mr. West gave that GoFundMe idea to fund him a thumbs down, with Kanye saying 'I don't want your money.' He must be counting on some walking around money, as he still has $53 million in debt. According to Kanye, his dreams brought him into debt but he is close to seeing the light of day.

Kanye's personal debt may be scary, but at least he and savvy wife Kim Kardashian keep their finances separate and file separate tax returns. That is smart tax-wise. However, that distance plus the sale of their Bel Air house for below its asking price may fuel divorce rumors. In any case, despite Mr. West's entreaty for cash, it doesn't look as though Mark Zuckerberg will invest $1 billion in Mr. West's musical ambitions. Maybe the money will come from Alphabet Inc.'s Larry Page?

Kanye West appears at the Brother Vellies Spring 2016 collection presentation during Fashion Week, in New York on Sept. 10, 2015. (AP Photo/Richard Drew, File)

If anyone does decide to funnel cash into Kanye's ideas, there may be four ways how Kanye West can get $1 billion tax free, with little or no tax hit. Now here's another. But before previewing that next funding idea, let's review the obvious choices. Loan, purchase, joint venture, or something else?

The easiest to figure is a straight loan. Loan proceeds aren't income, provided that it's a real loan. That's a key distinction that lands many taxpayers in trouble with the IRS. The $1 billion in loan proceeds would not be income to Kanye, and he should be able to deduct the interest payments. Mr. Zuckerberg just would report the interest as income.

If Mr. Zuckerberg should ever forgive the debt, it would be income to Mr. West then. That's cancellation of debt income, often shortened to COD income. But if Mr. West is bankrupt or insolvent, there could be no tax hit even if Mr. Zuckerberg forgives the loan! Think of it as a kind of silver lining to having financial problems.

If instead of a loan, Mr. Zuckerberg makes a purchase, what would he buy? Rights to some of Mr. West's intellectual property, perhaps? Depending on the details, a sale might be ordinary income or capital gain to Mr. West. The tax rate difference can be material, from 20% to 39.6%. That kind of spread can pay for a lot of tax planning.

What about a joint venture between Zuckerberg and West, a money partner and a services partner? The tax rules are complex, but it is often possible to get tax treatment you cannot get elsewhere. Sometimes, it may be possible to structure a transaction that looks rather like a sale as a joint venture that is more favorably taxed.

So what's the latest Kanye funding idea? How about a prepaid forward sale? Taking a page from the litigation funding industry, it works like this. A prepaid forward contract is basically a sale, not a loan. In the litigation context, the plaintiff selling a piece of his or her claim, or the lawyer selling a piece of the contingent fee. It arguably offers the best tax result for the plaintiff or the lawyer.

And it might fit Kanye West too. Because it's a sale, you might *assume* you have to report the sale proceeds as income. However, if set up properly, it is a sale contract with an unclear final return. In the litigation context, when you sign the documents and receive the money, you have entered a contract to sell a portion of your case (if you are the client), or a portion of your contingent fee (if you are the lawyer) when the lawsuit is resolved. That's why it is called a “forward” contract.

You are contracting to sell *now*, but the sale does not *close* until the case is resolved. The result is that you generally should not have to report income until the conclusion of the case. Only then can the final price be tallied.
It sounds similar to a loan, but is actually better in many cases. Most litigation funders do not like straight loans because of usury or regulatory rules. Prepaid forward contracts have the advantage of no immediate tax on the upfront payments, just like loans.

However, good documentation is critical. And on that note, ‘what would Kanye West sell’ is still a good question. But David Bowie’s recent death was a reminder that some people in the music business are prescient financiers. Clearly, Bowie was a musical visionary and financial pioneer with ‘Bowie Bonds’.

Whatever happens, if Mr. Zuckerberg and Mr. West do strike a deal, they should think about taxes up front, and document what they intend. How you structure a transaction is important, as is how the transaction actually plays out. Mr. Zuckerberg is clearly tax savvy, a little Buffett-like in his approach. As for Mr. West, the jury may still be out.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This article is not legal advice.