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Despite Tax Risks, 'Pay Me Next Year' Requests Are Big This Year-End

“Pay me next year” requests are common, from employees, suppliers, vendors, customers, and more. A delay of a few days might mean tax deferral for up to a year. Besides, on a cash basis, you probably *assume* you can’t be taxed until you receive money. Yet, if you have a legal *right* to payment but decide not to receive it, the IRS can tax you despite the delay. With tax cuts surely on the way, pushing income into next year when rates will be lower can be smart. In that and other ways, the Trump tax plan could impact your 2016 year-end planning.

One danger is the ’constructive receipt’ doctrine, which the IRS uses to police this very issue. If you have a legal right to a payment but elect not to receive it, the IRS can still tax you. The classic example is a bonus check your employer tries to hand you at year end. You may insist that you’d rather receive it in January, thinking you can postpone the taxes. However, because you had the *right* to receive it in December, it is taxable then.

If your company actually delays the payment (and reports it on its own taxes as paid in January) you may succeed in deferring the income. Yet even here, the IRS could claim that you had the *right* to receive it in the earlier year. The situation would be different if you negotiated for deferred payments *before* you provided the services. For example, suppose you are a consultant and contract to provide personal services in 2016 with the understanding that you will complete all of the services in 2016, but will not be paid until Feb. 1, 2017.

Is there constructive receipt? No. In general, you can do this kind of tax deferral planning as long as you negotiate for it up front and have not yet performed the work. Some of the biggest misconceptions about constructive receipt involve conditions. Say you are selling your watch collection, and a buyer offers you $100,000, even holding out the check. Is this constructive receipt? No, unless you part with the watch collection. If you simply refuse the offer—even if your refusal is purely tax-motivated because you don't want to sell the watch collection until January—that will be effective for tax purposes.

Because you condition the transaction on a transfer of legal rights (your title to the watch collection and presumably your delivery of it), there is no constructive receipt. Similarly, if you are settling a lawsuit, you can refuse to sign the settlement agreement unless it states that the defendant will pay you in installments. Even though it may *sound* as if you *could* have gotten the money sooner, there is no constructive receipt. You conditioned your signature on receiving payment in the fashion you wanted.

That is different from having *already* performed services, being offered a paycheck and delaying taking it. In that sense, the easiest planning is for assets you have not yet sold or obligated yourself to sell. Under current law, we pay tax at up to 39.6%. Add Obamacare's 3.8% surtax on net investment income, and the top federal rate for individuals is 43.4%. Trump proposes cutting the tax brackets to 12%, 25%, and 33%.

Plus, Trump said he would eliminate Obamacare's 3.8% net investment income tax. The top ordinary rate would be 33%, with the top capital gain and dividend rate 20%. If you sell in December, it is 2016 income, taxed at 23.8%, 39.6% or even 43.4%. If you sell in January, there's a good chance you get lower rates. Even if rates are unchanged, selling in December means taxes in April of 2017. Selling in January means taxes the *following* April, 2018! Conversely, if you have *losses*, they may be worth *more* in 2016. So consider selling losers now.

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