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THE TAX LAWYER

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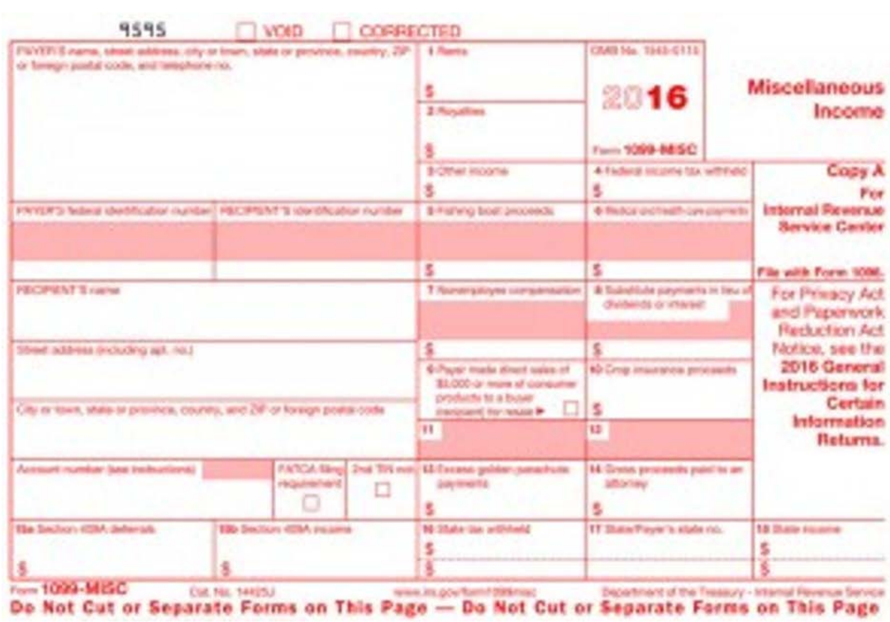
Non-Cash Income IRS Requires To Be Reported On Your Taxes

At tax time, it's easy to remember your wages, since you receive a Form W-2. It's also easy to remember income reported on [Forms 1099.](#) You probably get many Forms 1099, so don't lose them. But what isn't so clear is if you get income *without* cash, and it is more common than you might think. A variety of events can give you taxable income even though you've seen no cash. For example, consider constructive receipt. This tax rule requires you to pay tax when you have a right to payment even though you do not actually receive it.

The classic example of constructive receipt is a bonus check. Suppose your employer tries to hand it to you at year end, but you insist you'd rather receive it in January, thinking you can postpone the taxes. Wrong. Because you had the right to receive it in December, it is taxable then, even though you might not actually pick it up until January. On the other hand, if your company actually agrees to delay the payment (and actually pays it to you and reports it on its own taxes as paid in January) you would probably be successful in putting off recognition of the income until the next year.



9595 VOID CORRECTED

2016

Miscellaneous Income

Form 1099-MISC

Copy A For Internal Revenue Service Center

File with Form 1096.

For Privacy Act and Paperwork Reduction Act Notice, see the 2016 General Instructions for Certain Information Returns.

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Yet even in this circumstance, the IRS might contend you had the right to receive it in the earlier year. The IRS does its best to ferret out constructive-receipt issues, and disputes about such items do occur. 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 March 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.

If you are settling a lawsuit, you might 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 because 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. Tax issues in litigation are huge, and you should consider the bottom line after taxes, not before taxes. In fact, when settling litigation, you should always address taxes, preferably *before* you sign. Otherwise you may end up with a Form 1099 that you would rather not have.

Another type of non-cash income is if you have discharge of debt. It is also called cancellation of debt or "COD" income. If a relative or the bank loans you money, you get the cash but don't have income since you have to pay back the debt. But if you are relieved of the obligation to repay? That's usually COD income. Lenders are required to issue a Form 1099-C reporting COD income to the IRS, to ensure that you do not omit it from your tax return. There are a few exceptions. Debts forgiven while you're in bankruptcy–or if not in bankruptcy when you are technically insolvent with more debt than assets–do not count as income.

Finally, phantom income from entities can also be a big problem. Partnerships, limited liability companies (LLCs) and S corporations are pass-through entities. They are generally not taxed themselves; their owners are taxed. Each owner receives a Form K-1 that reports his or her appropriate share of the income (or loss), even if that income is retained by the business and not distributed to the owners. You are obligated to report it, regardless of whether you received any payout. The IRS matches Forms K-1 against individual tax returns.

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