

THE TAX LAWYER

Reporting This 2026 Item On Your 2025 Return Could Lower Your Taxes

[illegible]

Reporting a payment that you received in 2026 on your 2025 tax return sounds like poor tax planning. After all, a classic tenet of tax planning is to *defer* income and to *accelerate* tax deductions. Besides, how could something be income in 2025 if you don't collect it until 2026? Welcome to the concept of [constructive receipt](#). According to the IRS, you have income when you have an unqualified, vested right to receive it. Asking for payment later doesn't change that. The idea is to prevent taxpayers from manipulating their income.

What's Constructive Receipt?

The classic example is a check available in December which you ask to have held for you until January. Individuals are cash basis taxpayers filing annually, and it is usually not income until you receive it. But if you *could have* collected it, the IRS can tax it in December, even if you wait until January. This is an issue for cash method taxpayers like individuals.

Lawsuit Settlements

How does this work with legal settlements? Suppose a plaintiff orally agrees to settle a case in December but requires the money to be paid in January. In which year is the amount taxable? The fact that the plaintiff *could have* agreed to take the settlement in Year 1 does not mean the client has constructive receipt.

The plaintiff is free to condition executing a settlement agreement on the payment in Year 2. If you sign the settlement agreement and condition the settlement on payment next year, there is no constructive receipt. If you sign and the check does not show up until Year 2, that's also okay, it's Year 2

income. But if you sign in Year 1, and the defendant pays you *or your lawyer* in Year 1, it's too late to hold out to cash it until Year 2.

What if your lawyer receives the funds in Year 1, say December 24, 2025, but does not disburse the client's share until January 5, 2026? Is that income to the client in 2025 or 2026? You could argue either way, but the classic IRS position—upheld in tax cases—is that this is *2025* income, even if the lawyer doesn't pay the client until *2026*. For tax purposes, a lawyer is the agent of his client, so there is constructive or even actual receipt. The lawyer has the funds, and the client has a legal right to demand his share immediately.

Year-End Legal Settlements

Some lawyers and clients with year-end settlements argue that the client would need to sign forms, or another internal release with the lawyer to free up the cash. Those arguments can work in some cases, and there can be fee disputes between lawyers and clients that can play into it. But usually, when the lawyer receives settlement proceeds, the client is deemed to receive the client's share. Normally, it is the IRS who is birddogging issues of this sort, trying to move income from a later year to an earlier year.

But could a taxpayer ever argue for reporting in first year in our end of year lawyer payment example? Yes, if the argument about the lawyer being the client's agent works for the IRS, it can work for the taxpayer too. Why might someone be especially thinking about this in comparing 2025 and 2026 tax results?

Wildfire Recoveries

In late 2024, Congress when passed [a tax law to make many wildfire legal settlements tax free](#), but [this federal tax relief expires at the end of 2025](#).

There is a bill in congress to extend it, but it did not pass before the end of 2025. As a result, some fire victims seem likely to argue that if they can get their settlements in place with the funds arriving in their *lawyer's trust account* before 2026, the IRS's traditional position about constructive receipt should apply.

The bipartisan *Protect Innocent Victims of Taxation After Fire Extension Act* would make the tax exemption of the *Federal Disaster Tax Relief Act* permanent. While [wildfire survivors are waiting anxiously](#), this tax bill has not yet passed and it may not for some time. Now that 2026 is arriving, there is likely to be some scrambling by fire survivors and their lawyers to try to get in under the wire of the currently scheduled December 31, 2025 expiration of the current exclusion.