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Stormy Daniels Returning \$130K Trump Settlement Won't Escape IRS Taxes

When [Stormy Daniels offered to pay back her Trump settlement](#), she was proposing that by paying back the money, she should be allowed to talk. In many ways, that sounds reasonable, since the money was for silence, even though today her story would surely be worth millions. At some point, most of us have experienced wanting to go back to square one, to undo something we've done. Usually, only one side of the deal has buyer's remorse, and that means the deal will stick. Still, you might be surprised how many times transactions are undone, with both parties agreeing to go back. Sometimes a court compels it. What about the taxes?



Anytime you see a previously concluded deal unravel and go back to square one, it is worth asking about the IRS. Can you ever undo something on your taxes? The IRS gets a piece of just about everything, so you might think of the IRS as the third party in the deal. The IRS presumably took its share of Stormy

Daniel's \$130,000, and that was in the past. But what about going back to square one, undoing the deal, giving the money back? Does that work with the IRS too? Say that you sell your house, and six months' later you refund the money and take back the house. For tax purposes, you can argue that you really never sold it in the first place, and that you shouldn't have to report the sale on your tax return.

Similarly, suppose that you buy stock, but the company later refunds your money. Was that two transactions or none when it comes to your taxes?

The IRS stance depends largely on timing. Going back to square one may *sound* simple, but the tax system is rigid. You may call it a do-over, but the legal doctrine is *rescission*. When it comes to taxes, the tax system involves an annual accounting period of 365 days. Fortunately, the IRS agrees that some transactions can be unwound, and that the tax effects can be ignored. To pretend a deal never happened, you must meet two tough conditions:

- *Each* party must go back to its position *before* the transaction as if it never occurred. Rescission isn't a one-sided deal.
- The go-back must occur in the *same tax year* as the original deal. See [Revenue Ruling 80-58](#).

It's this timing rule that is usually the problem. Say you sell your house and the buyer claims the house is infected with mold. The dispute is unlikely to be resolved immediately. That usually means a subsequent tax year. To the IRS, each tax year must stand on its own. Some taxpayers who don't meet the IRS's strict same-year timing rule may be tempted to argue that a rescission qualifies as long as the transaction is unwound before they've reported the transaction on their tax return.

Example: You sell your car to your brother-in-law for \$25,000 in September 2017. He has some problems, so gives you the car back in March of 2018 and you refund the money. Although your 2017 tax return is due April 15th, you haven't yet filed it when you take the car back. When you file your 2017 return in April 2018 (or October if you go on extension), can you treat this sale as never having occurred? The IRS says no, but some taxpayers might try it.

The IRS has generally maintained a consistent position on this issue. However, the IRS has occasionally loosened up not about timing, but about the extent to which everything is returned to where it was. In several rulings, the IRS has approved a rescission even though one could argue that the parties didn't exactly go back to square one. For example, in [IRS Letter Ruling 200952036](#), a partnership was converted into a corporation, and then was converted back to a limited liability company (LLC). The partners didn't *entirely* go back to square one: when the smoke cleared they were members of an LLC, not partners in a partnership. Even though an LLC is not *exactly* the same as a partnership, the IRS agreed to treat the transaction as rescinded, having no tax affect.

Be careful, though. Any rescission involves at least two parties. Even in the simple car example, what if your brother-in-law has already filed his 2017 tax return before the rescission? He might even have depreciated or expensed the car, claiming that he owned it. It sure wouldn't fit with claiming the deal never happened. In more complicated deals, there may be many parties and more

entanglements that make it hard to go back. That's OK with the IRS. The IRS can probably collect taxes on the second transaction too.

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