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Stormy Daniels, Michael Cohen, Giuliani, Trump & Taxes

At first it appeared that Michael Cohen had paid off Stormy Daniels with his own money, and without President Trump's knowledge. Then, Rudy Giuliani said President Trump had reimbursed him. Then, there was some reshuffling about who knew what when. There were some awkward questions about whether President Trump knew of the deal at the time, or only learned of it later. The timing and mechanics of the reimbursement seem a little confused. From a tax viewpoint--which surely isn't the most important part of this story--many of these details may not matter. Even so, the tax issues are an interesting side show. Just about every kind of payment has tax consequences, to both the recipient and to the one who paid the money. That latter point has now been partially clarified.

There's no question that Stormy Daniels would have to pay tax on the $130,000 payment. Settlement money is almost always taxable to the recipient, unless it is for personal physical injuries or physical sickness. That is one of the rules about taxes on legal settlements. But on the payer side of the equation, it isn't so clear whether someone paying her could deduct the payment, leaving aside the

question of who effectively paid the money. Michael Cohen may have expected reimbursement at the time or only learned of the reimbursement later. Someone else was ultimately paying the bill.

For tax purposes, that suggests that Mr. Cohen was an agent, not the principal. Cohen may or may not have deducted the $130,000 payment as some kind of business expense. But should he have? When you pay for a business expense and your employer reimburses you, you might treat it as a wash, money in and money out with tax consequences. Or, you might claim the deduction, and report the income on the repayment. Most people prefer the former, so their taxes are easier, cleaner, and lower. It is really the principal who has the tax issue, the beneficial owner, not the agent who may be paying for someone else.

Federal income tax liability is generally allocated based on ownership under local law. In the case of bank accounts, there may be one nominal owner, but the money might effectively be held in trust for someone else. The IRS can try to tax the *beneficial* owner of an account, regardless of that person's rights to the funds under prevailing local law. The IRS and the courts often look beyond local law to impose taxes on the party who is the *beneficial* owner. People can and do become embroiled in tax disputes over such issues, and if you are the owner or principal, you are likely to be taxed.

Conversely, if you are just holding something as an agent for someone else, you generally should not be taxed. A *nominal* owner is *not* the owner for federal income tax purposes. In *Bollinger*, 485 U.S. at 349, the Supreme Court said that "the law attributes tax consequences of property held by a genuine agent to the principal". The Court enunciated a three-part agency safe harbor. Under it, you should not be treated as the owner for tax purposes if:

- A written agency agreement is entered into with the agent contemporaneously with the acquisition of the asset;
- The agent functions exclusively as an agent with respect to the asset at all times; and
- The agent is held out as merely an agent in all dealings with third-parties relating to the asset.

What if you don't meet all three conditions? The Tax Court has said that these *Bollinger* factors are non-exclusive. *See Advance Homes, Inc. v. Commissioner*, T.C. Memo. 1990-302. Even an *oral* agency agreement might suffice, although you surely want it in writing. Assuming a true agency, the agent should not face taxes on income over which he has no control and no beneficial right. As for Mr.

Cohen and President Trump, the unfolding details are likely to matter. Of course, most people are not going to be too worried about the tax issues.

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