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Trump Tax Cuts Trigger 'Pay Me In 2017' Requests, But IRS May Disagree

The election of Donald Trump, coupled with Republican control over the House and Senate, mean tax cuts are inevitable. So, deferring income into next year might be wise when rates should be lower. From that viewpoint, it seems obvious that the Trump tax plan could impact your 2016 year-end planning. Just be wary of the 'constructive receipt' tax doctrine, discussed below. Under current law, we pay tax on ordinary income tax at graduated rates stretching from 10% to 39.6%. Add Obamacare's 3.8% surtax on net investment income, and the top federal rate for individuals is 43.4%. Even capital gains now pay the extra 3.8%.

But next year there could be big changes. Trump proposes cutting the tax brackets to 12%, 25%, and 33%. Plus, 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%. Itemized deductions would be capped at $200,000 for married couples. These potential changes suggest paying state taxes before 2016 ends, and the same for charitable contributions. Businesses are also supposed to be in for big tax cuts.

Corporations currently pay 35%. Trump has said he would cut it to 15%, and eliminate most business deductions. LLCs, partnerships and S corporations would have changes too, possibly even paying the same 15% rate as corporations! Of all the proposed tax changes, this one seems the most unlikely. It could mean someone taxed on flow-through business income at 39.6% or 43.4% could see their tax rate slashed to 15%! But if even half of these changes are passed, consider selling assets or collecting big pay in 2017 if you can.

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. It is standard to defer income and accelerate deductions. Even if rates are unchanged, selling in December means taxes in April. Selling in January means taxes the *following* April! All the more so this year. In fact, some taxpayers who ink a deal in 2016 may call for proceeds in 2017. Just be careful how you do it.

Conversely, if you have *losses*, they may be worth *more* in 2016. So consider selling losers now. Deferring income—pushing it off into the future—requires care. Many employees may not be able to do this, but business people can. You can be slow with billing and collection. Businesses, too, should accelerate deductions and defer income. If a business needs equipment, buying in 2016 is probably smarter than in 2017.

Both individuals and businesses should beware of 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. 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.

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 might contend 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.

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. 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.

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