Forbes

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THE TAX LAWYER

TAXES 11/06/2017

Under Tax Bill, Should You Take 2017 Payment, Or Defer Until 2018?

The Tax Cuts and Jobs Act here is a complex 429 pages, so you may want to start with a summary of the plan. It isn't inked yet, and make no mistake, there's jockeying going on in Washington. All that adds considerably to the usual year-end tax shuffle. Even without the mad scramble caused by a major tax bill at year-end, as the holiday season approaches, many taxpayers start thinking about their taxes. People who are about to come into a sizable sum have *extra* reasons to plan. You might be settling a lawsuit, selling your company, or selling a nice cache of highly appreciated bitcoin or other cryptocurrency. You might be collecting a fat consulting contract, and timing the payment of an outsize invoice. You might be exercising stock options, which involves *buying* stock, but can trigger taxes on that purchase.

If you work for pay and are entitled to money now, the IRS can disregard requests to be paid later under the doctrine of 'constructive receipt.' It can make something taxable now, even if you don't receive it until later. However, there is often considerable tax planning that sellers, litigants, and others can do. Sales can be inked now, but closed later. Even litigation can be settled, but with payments later. You still might worry about the tax doctrine of constructive receipt. Yet the seller or plaintiff holds legal rights, and is free to condition an agreement on the payment in the later year. As long as the sale or settlement agreement is not signed until the agreed payment terms are clear, the timing stated in the sale or settlement agreement should control the taxes.

These rules usually mean that sellers and litigants are free to enter into agreements in 2017 that call for payments in 2017, in 2018, or some of each. Even without tax rate and other changes, there is usually a tax deferral advantage to a January payment. Taxes are normally due in April for the prior year. In that sense, a delay of a month from December to January can make tax payments due a *whole year later*, in the *following* April. And then there is tax reform. In the sausage-making of tax reform, try to analyze if you are better off in 2017 or 2018. If you can, run the numbers both ways. Potential lower rates for some (such as flow-through income), and repeal of the alternative minimum tax are two big changes that could impact many. These two potential changes alone could fuel some “pay me next year” requests.

IRS Forms 1099 generally arrive in January, for payments made in the prior year. Is it better to get paid late in the year, so any Forms 1099 come right away? If you are paid in January, you won’t receive a Form 1099 for 12 months. However, this issue should generally not impact the timing decision. However, if the taxes due on the sale or the legal settlement are not obvious, additional time can be another reason to push the deal into 2018. Sale or settlement money in December 2017 means a tax return due in April 2018. If a tax opinion must be prepared before tax returns can be filed, having over a year before tax returns are due is better than only having a few months.

Another factor can be timing moves. Some sellers or plaintiffs want to change residences before receiving funds, for tax and other reasons. No-tax states such as Nevada, Washington, Texas and Florida may beckon. That may suggest a delay. Of course, consider too that the tax bill kills state tax deductions, making California and other high tax states extra expensive. Even if you move, there is no way to guarantee that the state you are leaving will not try to claim a piece of the sales proceeds or the legal recovery. And if you are selling California real estate, for example, even moving away won't help. That can be taxed by California even if you live on Mars! In contrast, if your sale is of intangible property (say shares of stock in a company), that generally should be sourced at your state of residence, so moving can help. And time (such as a payment in 2018) may help with that.

As you consider 2017 vs. 2018 payments, get some advice and run some numbers. Some people may even want to opt for some payments in 2017, and some in 2018. Whatever you do, remember that one size rarely fits all. So think it through, and consider the non-tax as well as the tax aspects of your deal. Be careful, and try to make sure you know what you are getting before you sign.

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