Robert W. Wood
THE TAX LAWYER

TAXES 09/30/24

With Tax Changes Likely, Should You Collect Payments In 2024 Or 2025?

There are a few months left in 2024, so does it make sense to even think about this yet? It might, especially in this election year. Both Harris and Trump have pledged tax changes, and with the Trump tax cuts expiring, there's sure to be changed. Many people, particularly those with higher incomes, are likely to pay higher taxes if Vice President Harris is elected. Of course, Congressional races are key to tax hikes too. In any event, in the waning months of the year, it usually makes sense to consider this.

A classic tenet of tax planning says that you should generally try to accelerate tax deductions and defer income where you can. Timing invoicing, and even "pay me next year" requests are common with employers, suppliers, vendors, customers and more. On a cash basis, you probably assume that you can't be taxed until you receive money. But technically, if you have a legal right to payment but decide not to receive it, the IRS can tax you nonetheless.

Is that fair? The IRS thinks so. The tax law includes the concept of *constructive* receipt. It requires you to pay tax when you merely have a right to payment even though you do not actually receive it.

Given taxes and filing deadlines, would your prefer payments in 2024 or the first week in January? If you are paid in December of 2024, taxes are due April 15, 2025. If you are paid in January 2025, taxes are due April 15, 2026. It seems like an easy decision, but if taxes could go up, it may cut the other way. Vice President Harris has proposed hiking tax rates from 37% to 39.6%, plus taxing long-term capital gains at 28% for income above $1 million.

You can clearly time sales of assets—stock, crypto, or real estate—with taxes in mind. But with some types of income, it is not just about making a decision. If your employer tries to hand you a bonus check at year-end, you might insist you'd rather receive it in January, thinking you can postpone the taxes. Because you had the right to receive it in December, it is taxable then, even though you might not actually pick it up until January.

As a practical matter, if your company agrees to delay the payment (and actually pays it to you and reports it on its own taxes as paid in January) you would probably be successful in putting off the income until the next year. Besides, with wages like a bonus, the W-2 you receive will control. Yet even here, the IRS can say you had the right to receive it in the earlier year. The IRS does its best to ferret out constructive-receipt issues, and disputes about such items do occur.

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 2024 with the understanding that you will complete all of the services in 2024, but will not be paid until Feb. 1, 2025. Is there constructive receipt? There shouldn't be. 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. Suppose you are selling your house or crypto. A buyer offers you money and even holds out a check. Is this constructive receipt? No, unless you part with the crypto or house. If you simply refuse the offer—even if your refusal is purely tax-motivated because you don’t want to sell until January—that will be effective for tax purposes. Because you condition the transaction on a transfer of legal rights (your title and delivery), 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 because you conditioned your signature on receiving payment in the way you wanted. That is different from having *already* performed services, being offered a paycheck and delaying taking it. Tax issues are almost always present in lawsuit settlements. Consider how the IRS taxes legal settlements and legal fees. If you don't plan ahead you may end up with an IRS Form 1099 you don't really want.

Check out my website.