



# Talking 1099s

Answers to eight questions attorneys should ask about the IRS form

BY ROBERT W. WOOD

IRS Form 1099 allows computer matching of Social Security numbers and dollar amounts, so IRS collection efforts are streamlined and mechanized. Most people pay attention to these forms at tax time, but lawyers and clients alike should pay attention to them the rest of the year, too. Failing to include income on a 1099 Form, or at least explain it on your tax return, is guaranteed to get you an IRS tax notice to pay up. Lawyers also make good audit subjects because they handle client funds, and the IRS has a keen interest in the tax treatment of litigation settlements, judgments, and attorney fees.

## 1 Who is required to issue 1099 Forms?

Each person engaged in business and making a payment of \$600 or more for services must report it on a 1099 Form. The rule is cumulative, so while one payment of \$500 would not trigger the rule, two payments of \$500 to a single payee during the year require a 1099 Form for the full \$1,000. Lawyers must issue 1099

Forms to expert witnesses, jury consultants, investigators, and even co-counsel where services are performed and the payment is \$600 or more.

Payments to corporations for services are generally exempt from the requirement of issuing a 1099 Form. A notable exception applies to payments for *legal* services: any payment for services of \$600 or more to a lawyer or law firm must be the subject of a

1099 Form, regardless of whether the law firm is a corporation, LLC, LLP, or general partnership.

Finally, a client paying a law firm more than \$600 in a year as part of the client's business must also issue a 1099 Form.

## 2 What is the deadline to issue 1099 Forms?

1099 Forms are usually issued in January of the year after payment. In general, they must be dispatched to the taxpayer and the IRS by the last day of January.

## 3 Are lawyers required to issue 1099 Forms to clients?

Although some firms issue the forms routinely, most payments to clients do not actually require it. Of course, many lawyers receive funds that they pass along to their clients. That means law firms often cut checks to clients for a share of settlement proceeds. Even so, there is rarely a Form 1099 obligation for such payments. Most lawyers receiving a joint settlement check to resolve a client lawsuit are not considered payors. But see No. 6. In the majority of personal injury cases, the settling defendant is considered the payor, not the law firm. Thus, the defendant generally has the obligation to issue the 1099 Form, not the lawyer.

## 4 Are 1099 Forms required in personal injury cases?

One important exception to the rules for 1099 Forms applies to payments for personal physical injuries or physical sickness. Because such payments for compensatory damages are generally tax-free to the injured person, lawyers are not generally required to issue 1099 Forms.

However, lawyers will often be *receiving* 1099 Forms when their names are on settlement checks. IRS regulations contain extensive provisions governing joint checks and how 1099 Forms should be issued in such cases.

**Example:** Defendant settles a case and issues a joint check to Client and Attorney. Defendant normally must issue one 1099 Form to Client for the full amount and one 1099 Form to Attorney, also for the full amount.<sup>1</sup>

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## 5 Is a 1099 Form required for client refunds?

If the refund is of monies held in the lawyer's trust account, no 1099 Form is required. However, if the law firm was previously paid and is refunding an amount from the law firm's own income, a 1099 Form is needed.

## 6 When *must* a lawyer issue a 1099 Form to a client?

Under IRS regulations, if lawyers perform management functions and oversight of client monies, they become "payors." As such, they are required to issue 1099 Forms when they disburse funds. The tax regulations are not terribly clear about exactly what these management and oversight functions are; however, just being a plaintiff's lawyer and handling the settlement monies is not enough.

## 7 What are the penalties for failure to issue a 1099 Form?

As noted above, lawyers are not always required to issue 1099 Forms, especially to clients. Where they are required, however, enforcement of penalties for failure to file has gotten tougher. More and more reporting is now required, and lawyers and law firms face not only the basic rules but the special rules targeting legal fees.

**A taxpayer who knows that a 1099 Form is required to be issued and nevertheless ignores that obligation is asking for trouble.**

Most penalties<sup>2</sup> for non-intentional failures to file are, however, modest—as small as \$270 per form not filed. In addition to the \$270-per-failure penalty, the IRS also may try to deny a deduction for the item that should have been reported on a 1099 Form. That means if you fail to issue a form for a \$100,000 consulting fee, the IRS could claim it is non-deductible. It is usually possible to defeat this kind of draconian penalty, but the severity of the threat still makes it a potent one.

An often-cited technical danger (but generally not a serious risk) is the penalty for intentional violations. A taxpayer who *knows* that a 1099 Form is required to be issued and nevertheless *ignores* that obligation is asking for trouble. The IRS can impose a penalty equal to 10 percent of the amount of the payment.

## 8 What about IRS Form W-9?

Because a 1099 Form requires taxpayer identification numbers, attorneys are commonly asked to supply payors with their own taxpayer identification numbers and those of their clients.<sup>3</sup> Usually such requests come on IRS Form W-9. If an attorney is requested to provide a taxpayer identification number and fails to provide it to a paying party, he or she is subject to a \$50 penalty for each failure to supply that information.

*NOTE: This discussion is not intended as legal advice.* **BN**

### NOTES

1. This reality may cause the attorney to prefer separate checks, one for the client funds payable to the client, and one check paid to the attorney directly, so that the attorney receives a 1099 Form for only the attorney's fees and not also for the client's money.
2. [www.irs.gov/government-entities/federal-state-local-governments/increase-in-information-return-penalties](http://www.irs.gov/government-entities/federal-state-local-governments/increase-in-information-return-penalties).
3. The payments to be made to the attorney also may be subject to withholding. As a practical matter, some defendants may refuse to pay over money without the required taxpayer identification numbers, or will seek to pay the money through a court. It is usually not worth fighting over W-9 Forms. If you have negotiated for language in the settlement agreement making clear what 1099 Forms will (or will not) be issued, there should be no reason to fight over providing W-9 Forms.