Forbes.com

The Tax Lawyer

Ten Things You Should Know About 1099s

Robert W. Wood, 01.27.10, 5:00 PM ET

OK, this is no one's favorite topic. As a taxpayer, you probably hate receiving 1099s. If you're in business, you probably hate sending them out. In fact, no one likes 1099s except the IRS. The agency loves them because they allow its computers to keep tabs on ordinary taxpayers, even while it audits less than 1% of all individual tax returns. The IRS matches nearly all 1099s and W-2s (those are the wage report forms from your employer) against your 1040. In fiscal 2008 it sent 4.8 million notices to taxpayers saying that based on those matches, they owed more. By contrast, it audited fewer than 1.3 million returns. Here are 10 things you need to know about the 1099s hitting your mailbox now.

1. It's better to give than receive.

This time of year they're inevitable. Generally, businesses must issue the forms to any payee (other than a corporation) who receives $600 or more during the year. And that's just the basic threshold rule; there are many, many exceptions. That's why you probably get a Form 1099 for every bank account you have, even if you earned only $10 of interest income.

2. There are many varieties of 1099.

There's a 1099-INT for interest; 1099-DIV for dividends; 1099-G for state and local tax refunds and unemployment benefits; 1099-R for pensions and payouts from your individual retirement accounts; 1099-B for broker transactions and barter exchanges; 1099-S for real estate transactions, etc. In fact, there's a dizzying array. There are many categories, but the Form 1099-MISC (for miscellaneous) seems to prompt the most questions and covers the biggest territory.

3. Timing is everything.

Normally, businesses must send out Forms 1099 on or before Jan. 31 of each year for the prior calendar year. This year the IRS gave some types of payers a reprieve until Feb. 16. That means you should watch your mailbox carefully a little longer this year. Some businesses send a Form 1099 at the same time they send you a check so they won't have to send you a form later. That means you *might* receive a Form 1099 at any time of the year. So keep a lookout for Forms 1099 with checks during the year and put them in a safe place. Don't assume you're off the hook for reporting income if you don't receive a Form 1099 by February or even March. There are penalties on companies who issue 1099s late, but I've seen some arrive as late as April or May. That may mean you will already have filed your tax return. If so, there's usually no obligation to amend your tax return as long as you thought it was correct when you filed it.

4. Beware changed addresses.

Whether or not the payer has your correct address, the information will be reported to the IRS (and your state tax authority) based on your Social Security number. That means you have an interest in making sure payers have your correct address. Update your address directly with payers, as well as putting a forwarding order in with the U.S. Post Office. You'll want to see any forms the IRS sees.

5. The IRS gets them, too.

Any Form 1099 sent to you goes to the IRS too--often a little later. The normal deadline is Jan. 31 for mailing 1099s to taxpayers, but the payer has until the end of February to send all its 1099s to the IRS. Some payers do send them simultaneously to taxpayers and the IRS. Most payers mail taxpayer copies by Jan. 31, and then wait a few weeks to collect all of the IRS copies, summarize them and transmit them to the IRS, usually electronically. That's important knowledge, so don't let it go to waste.

6. Report errors immediately.

The time delay means you may have a chance to correct obvious errors. So don't just put arriving 1099s in a pile; open them immediately. Suppose you get a 1099-MISC on Jan. 31 reporting $8,000 of pay, when you know you received only $800 from the company that issued the form? Tell the payer immediately. There may be time for the payer to correct it *before* sending it to the IRS. That's clearly better for you. If the payer has already dispatched the incorrect form to the IRS, ask the payer to send in a corrected form. There's a special box on the form to show it is correcting a prior 1099--so the IRS doesn't just add the amounts together!

7. Report every 1099.

The key to Forms 1099 is the IRS' computerized matching. Every Form 1099 includes the payer's employer identification number and the payee's Social Security (or taxpayer identification) number. The IRS matches nearly every Form 1099 with the payee's tax return. If you disagree with the information on the form but you can't convince the payer you're right, explain it on your tax return. Example: Suppose you received a $100,000 payment from your car insurance company to cover your medical expenses and pain from whiplash you suffered in an accident. A payment for personal physical injuries is excludable from income, and it shouldn't normally be the subject of a Form 1099. If you haven't succeeded in convincing your insurance company to cancel the 1099, try to explain it on your tax return. One possibility is to include a zero with a "see note" on line 21, the "other income" line of your Form 1040. Then in the footnote, show something like this:

Payment erroneously reported by XYZ insurance on Form 1099: $100,000

Amount excludable under Section 104 for personal physical injuries: $100,000

Net to Line 21: $0

There's no perfect solution, but one thing is clear: If you receive a Form 1099, you can't just ignore it, because the IRS won't.

8. IRS "dunning letters."

No one likes a tax audit, and there are numerous tales about what will provoke one. But this much is clear: If you forget to report the $500 of interest you earned on a bank account, the IRS will send you a computer-generated letter billing you for the tax on that interest. If it's correct, just pay it.

9. Consider state taxes, too.

Most states have an income tax, and they will receive all the same information the IRS does. So if you missed a 1099 on your federal return, be aware that your state will probably catch up with it, too.

10. Don't ask.

Keeping payers advised of your current address is a good idea, as is reporting errors to payers. But that's where I'd stop. In other words, if you don't receive a Form 1099 that you expect, don't ask for it. If you are expecting a Form 1099, you no doubt know about the income, so just report that amount honestly on your tax return. The IRS computers have no problem with that. In my experience, if you call or write the payer and raise the issue, you may be buying trouble. The payer may issue the 1099 incorrectly. Or you may end up with two of them, one issued in the ordinary course (even if it never got to you) and one issued because you called. The IRS computer might end up thinking you had twice the income you really did.

Forms 1099 are a vital part of the IRS's computer matching program, and nearly all of us receive payments reported in this way. Take these forms seriously. I assure you the IRS does.

Robert W. Wood is a tax lawyer with a nationwide practice. The author of more than 30 books including Taxation of Damage Awards & Settlement Payments *(4th Ed., 2009), he can be reached at wood@woodporter.com. This discussion is not intended as legal advice and cannot be relied upon for any purpose without the services of a qualified professional.*

See Also:

Ten Ways To Audit-Proof Your Tax Return

Three Tax Mistakes You Make Every Day

Ten Tips For Deducting Your Hobby

How To Cheat Like A Pro