

# Do Lawyers Need to Send IRS Forms 1099 to Their Own Clients? Here's Why Not

By Robert W. Wood

Suppose that you are a plaintiff attorney with a client who is receiving a large settlement. The settlement proceeds are being deposited into your client trust account, and it is your responsibility to disburse them to your client after taking your contingent fee. This final transaction between attorney and client may seem perplexing from a tax perspective. Who exactly is the payer of these funds, or are there multiple payers involved?

Some lawyers believe they are erring on the side of caution by issuing their client an IRS Form 1099 to match the amount of the disbursement. But is this required by the IRS, or is it otherwise a good idea? A close look at the Internal Revenue Code and related Treasury Regulations shows that issuing a Form 1099 to your own client is not required, except in a few rare situations. As to whether it is somehow safer or a good idea for the lawyer to issue a Form 1099, I don't believe it is.

Notably, issuing a Form 1099 to the client does not improve the lawyer's tax position and it does not somehow make the lawyer's tax return more pristine or indicate a better degree of tax compliance. It is merely filing a form that is not legally required. And the lawyer's Form 1099 can materially prejudice the client's own tax position. I will try to cover each of these points.

First, let's consider why this topic matters. IRS Forms 1099 are used to report payments outside the employment relationship. They allow the IRS to match Social Security numbers with dollar amounts paid and received, streamlining their collection efforts. Generally, these forms report income of one type or another, affecting the taxes you pay. However, there's an important exception that lawyers and their clients should understand: the reporting of *gross proceeds to lawyers*.

Some attorneys believe that they *need* to issue a Form 1099 to their clients so they can deduct the client's portion of a settlement from the lawyer's income. In reality, an attorney is not required to include their client's portion of a settlement in their gross income in the first place. This is so even if—as is typical—100% of the settlement is reported to the attorney on a Form 1099.

The reason is the unique type of Form 1099 that only lawyers receive for settlement proceeds. Defendants send lawyers a Form 1099-MISC with the amount filled in on Box 10, which is only for "Gross Proceeds Paid to an Attorney." Clients, on the other hand, may receive a Form 1099-MISC, Box 3 (which is for "other income"), or a Form 1099-NEC. The latter is for non-employee compensation, which triggers self-employment taxes, in addition to income tax.

As nearly every taxpayer knows, Forms 1099 are matched with taxpayer Social Security numbers or taxpayer ID numbers. That way, the IRS can easily see if the payment was reported on your tax return. However, the "Gross Proceeds Paid to an Attorney" box on Form 1099-MISC is unique. It is *not tracked as income*, period, not to the lawyer or to the client.

It is just a payment to a lawyer or law firm. Even a payment of \$10 million or \$100 million of gross proceeds paid to an attorney reported on a Form 1099-MISC in Box 10 is simply a payment, not income.

If *none* of the payment is income to the lawyer, the lawyer can ignore the Form 1099. If *some* of the payment is income—as it often is with case settlement proceeds—the lawyer just reports as income those fees. The lawyer does not need a Form 1099 to report income—there is no IRS matching problem if the lawyer reports income that was not the subject of a Form 1099—which is effectively the result when a gross proceeds Form 1099 is issued.

Suppose that a case settles for \$10 million, and 40% of that is the lawyer's fee. The lawyer can expect a Form 1099 for \$10 million, but it will be a gross proceeds Form 1099 that is merely reporting the payment transaction—without any characterization whether it is income or not. It is just a payment to a lawyer or law firm. If 40% of a \$10 million Form 1099 is income to the lawyer, the lawyer reports that \$4 million as income.

The lawyer should *not* report the whole \$10 million as income and then deduct the \$6 million payment to the client. The \$10 million clearly was not income to the lawyer, only \$4 million was. A prime technical reason that the lawyer should not issue a Form 1099 to his own client is that the lawyer is not the "payor" of the money. Even if the proceeds are disbursed by the lawyer to his client, the payor of that money with Form 1099 obligations was *the defendant*.

The lawyer is receiving the \$10 million as an agent for the client and, to the extent of the lawyer's fee, for the lawyer's own account. However, the Form 1099 rules are clear that any Form 1099 issuance responsibilities belong to the *payor* of the funds, which is the settling defendant. Despite these clear rules, there are very occasionally situations in which lawyers might need to issue Forms 1099. But simply being a plaintiff's lawyer and handling settlement money as attorneys do clearly does not impose that obligation.

If a Form 1099 is not required—as it is not here—the IRS does not want or need the form. What's more, if you issue a form to your own client, there is material prejudice to your client. If a plaintiff's attorney issues a Form 1099 to the client, the client may end up receiving two different Forms 1099 for the same settlement payment, one form from the defendant and another form from their own attorney. This redundancy complicates the client's tax return, creates undue stress and can trigger extra taxes to your client. *Except* for gross proceeds Forms 1099 issued to lawyers, the IRS assumes that any Form 1099 is income. Moreover, if the case is a physical injury case, so the funds are tax free, that is an independent reason not to issue the form.

Is there any other reason lawyers sometimes have the knee jerk reaction to issue a Form 1099 to their own client? Some lawyers say there might be an IRS penalty if they don't. Once again, that is untrue. Lawyers disbursing a client's share clearly are not obligated to issue the form. So no penalty is

possible. And as a matter of interest, how much is a Form 1099 penalty in the first place? Under \$500 in most cases, and that's only where the form is *required*, which it clearly is not here.

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