

Employment Settlement Claims: Should You Sign IRS Form 4669?

By Robert W. Wood

IRS Form 4669 is signed by the recipient of a payment, confirming that they included it in their income *and* paid self-employment tax. It is used by companies to reduce or avoid liability to the IRS, if the IRS later says they *should* have treated the payment as wages and withheld income and employment taxes. If the recipient reports the payment as income and pays self-employment tax, a failure to withhold penalty seems moot.

Technically, Form 4669 does not *prevent* the IRS from penalizing the employer for failing to withhold. Still, it reduces the employer's liability for the underpayment of the employment and income tax. An employer settling a lawsuit may require the employee to sign the form, a little like requiring an IRS Form W-9. A Form W-9 is standard at settlement time, or in most any other context where someone is making payment.

A Form W-9 confirms the person's Social Security Number, and their U.S. tax status. If you want to be paid, you may need to sign a W-9. And if you refuse, the payor can do "backup withholding" at a 24% rate, so most people sign the Form W-9. But is Form 4669 similarly innocuous, and is it appropriate to require it for employment suit settlements? It is hard to see how.

Perhaps the form is being requested because some employers may be facing pressure to treat little or nothing as wages. In that context, they may be trying to shift that burden to the departing employee. However, the instructions to Form 4669 say that the purpose of a Form 4669 is to allow an employer to avoid penalties for failing to withhold taxes by demonstrating that the employee *already paid* the taxes. In most employment suit settlements, one amount is treated as wages, and another amount is reported on a Form 1099.

The universal expectation is that there will be withholding on the first part, and no withholding on the second. The non-wage portion is not wages and is therefore not subject to withholding or payroll tax. The plaintiff will *not* be paying self-employment tax on the Form 1099 portion. If the plaintiff is required to provide Form 4669 to the employer, how could a plaintiff fill out the form?

The classic context in which a Form 4669 is appropriate is when it may not be clear if the recipient is an employee or independent contractor. The payment is compensation for services and is *either* wages or self-employment income. The only question is whether the company must treat the payment as wages. In those cases, the payor may want to obtain a completed and signed Form 4669 from a putative independent contractor. But again, there is an awkward timing question, since Form 4669 is supposed to certify that the taxes were already paid.

The tax case of *Mescalero Apache Tribe*, 148 TC 291 (2017), shows how this is supposed to work. The IRS had reclassified the tribe's independent contractors as employees. The IRS therefore determined that there was payroll tax due

from the tribe. However, because the contractors believed themselves to be contractors, they had voluntarily paid self-employment tax on the same payments that effectively satisfied the tribe's payroll tax obligations.

Accordingly, the *Mescalero* case affirms that Form 4669 is appropriate and intended for situations where a payment would be subject to either wage withholdings *or* self-employment tax, depending on whether the recipient is classified as an employee or a contractor. In those cases, the payor *can* properly obtain a completed and signed Form 4669 from a putative independent contractor. That way, even if the IRS challenges the employee/contractor status of the payee, the payor has proof that the employment tax or self-employment tax was already paid.

In most employment settlements, employee vs. independent contractor status is not an issue. Again, most involve a wage payment and a nonwage payment reported on Form 1099. The non-wage payment is not wages and is not subject to withholding. It is also not paying an independent contractor for services.

Ultimately, defendants should be comfortable with the amount they are treating as wages, and the amount they are agreeing not to treat as wages. The latter may be called a payment for emotional distress, for nonwage damages, etc. Depending on the amounts in these two categories and on the facts in the case, it is theoretically possible that the IRS could seek to reallocate more to the wage category.

But it is exceedingly rare in practice, and even the IRS states that they rarely disturb an agreed-upon settlement agreement on these issues. In any case, a Form 4669 would not provide complete protection against potential taxes, interest and penalties if the non-wage portion is later determined to be too high. And then there is the chicken or egg timing.

Form 4669 requires an employee to assert *under penalties of perjury* that a payment has been reported as income and that all taxes have been paid. It is hard to see how such a statement can truthfully be made when a settlement agreement is signed. At the earliest, it could only be made after the plaintiff has *already* filed their tax return and paid the resulting tax. That might be a year or more later.

Even so, some employers may insist on receiving a signed Form 4669. And some plaintiffs who are trying to get a settlement completed and signed may be tempted to sign the form, even if they do so in blank. If a plaintiff has not yet filed their tax return and paid any resulting tax, they should not sign forms under penalties of perjury asserting that they have. Besides, Form 4669 requires a plaintiff to state exactly how and where the income was reported on the relevant tax return.

At the time a settlement agreement is signed, the plaintiff may not know how and exactly where on their tax return they will report their settlement. That kind of discussion tends to happen closer to the tax return deadline the following year. Indeed, at the time of settlement, the IRS may not have even released the final versions of the tax forms for the upcoming filing season. How could a plaintiff accurately

identify at the time of settlement what lines on the tax forms will be used to report the recovery the next year?

If a defendant feels it needs to have a Form 4669 from the plaintiff, it may be best to position it as a promise of *future* cooperation. For example, a plaintiff might agree to provide a Form 4669 to the defendant at a later date (after the plaintiff's tax returns are filed) if the defendant's tax return is audited and if the IRS attempts to impose additional taxes due.

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