

IRS Form W-9 Requests and Backup Tax Withholding

By Robert W. Wood

With backup withholding, when you file your tax return you are trying to get the IRS and the FTB to apply the withheld money to your account, not to someone else'. It is not as easy as you might think.

Before paying you, most companies will ask for an IRS Form W-9 so they can issue you an IRS Form 1099. Can you sidestep the tax reporting by being cagey about your Social Security number or taxpayer ID number? It can be pretty tough to do, if you want to get paid. Any Form 1099 requires taxpayer identification numbers, so attorneys are commonly asked to supply payers with their law firm's ID number and those of their clients.

Suppose that a lawyer settles a case for \$1 million, with payment to the lawyer's trust account. Assume that 60 percent is for the client, and 40 percent is for the lawyer. The lawyer is sure to receive a Form 1099 reporting the full \$1 million as gross proceeds. The lawyer can report as income the \$400,000 fee without worrying about computer matching, since gross proceeds do not count as income.

The client isn't so lucky. Unless the settlement is a non-income settlement (say, compensatory damage for personal physical injuries) or a capital recovery, the client will probably receive a Form 1099-MISC (probably in Box 3) for the full \$1 million. The client must then figure out if he can deduct the \$400,000 in legal fees. Since 2018, it is harder to find a way to claim legal fee deductions in many kinds of cases. As a result, Forms 1099 are even more important.

A Form W-9 verifies your taxpayer ID number, typically your Social Security Number, or if you are a company, your employer identification number. If you want to be paid, refusing to hand over a W-9 may not make sense. The IRS says that anytime a payor thinks they may have to report a payment on an IRS Form 1099, they should ask for a Form W-9. If they fail to get one signed, they may have to withhold taxes on the payment, even if you are not an employee.

This "backup withholding" at 24% is the usual consequence of refusing to hand over a Form W-9. Forms 1099 allow computer matching of Social Security numbers and dollar amounts paid and received, so IRS collection efforts are streamlined. Failing to report a Form 1099 on your tax return (or at least explain it) triggers an IRS notice asking you to explain or pay up. Thus, if you receive a Form 1099, report it, even if you are claiming that the money should be tax free.

To get paid, you and your client are likely to be asked to sign and return a Form W-9. Should lawyers and clients agree? Usually, if they don't agree the money simply will not be paid, or the payor will withhold 24% and send it to the IRS. What's more, they will withhold another 7% and send it to the California Franchise Tax Board. Just think about that.

If the payor is doing backup withholding, they do not have your tax ID number, which is why they requested a Form W-9. So they send the money off to the IRS and the FTB just with your name and address. Bear in mind that at the IRS and the FTB,

nearly everything is controlled by your social security number (for individuals) or your employer identification number if you are in business. But with backup withholding, that can't work.

When you are an employee and file your tax return, all the tax withholding is taken out and routed to the IRS and the state under your Social Security Number. So almost nothing can go wrong. But with backup withholding, when you file your tax return, you are trying to get the IRS and the FTB to apply the withheld money to *your* account, not to someone else's. It is not as easy as you might think.

Even so, many people are reluctant to hand over a signed W-9. There's the privacy factor, can you trust them with your Social Security Number? There's also the seemingly inevitable Form 1099 you will receive. Suppose that you are a plaintiff in a physical injury case who has just secured the agreement of the defendant not to issue a Form 1099. That is a victory, so why would you supply a Form W-9?

After all, the purpose of the Form W-9 is to provide and verify the taxpayer's Social Security number. Doesn't having the form *necessarily* mean that the defendant will issue a Form 1099? Not really, it may just mean that this defendant won't pay much of anything to anyone without a signed form.

In addition to supplying a payee's Social Security number, the Form W-9 certifies that the recipient is a U.S. person (that is, a U.S. citizen or tax resident), and therefore is not subject to the onerous reporting and withholding obligations often required for "outbound" payments to non-U.S. persons. Thus, many companies have a policy of requiring signed Forms W-9 for *any* payment.

It doesn't appear to be commonly invoked, but there is a potential penalty for refusing to provide a signed Form W-9 when requested. If a payee is requested to provide a taxpayer ID number and fails to provide it to a paying party, he is subject to a \$50 penalty for each failure to supply that information. A more effective remedy is likely to be the threat of 24% backup withholding. A payee who provides false or inaccurate information or who refuses to hand over a Form W-9 when requested is subject to backup withholding on the payments.

In the end, when a payer requires a Form W-9, it is usually not worth fighting about providing it, especially if there is already an understanding about which Forms 1099 will be issued. Disputes about Forms 1099 are common. The Form 1099 regulations are complex, which causes many businesses to err on the side of issuing the forms.

Recipients may not like this, and lawsuits for issuing Forms 1099 are filed on occasion. Most such suits don't seem to go very far, perhaps precisely because it is often possible to justify whatever was issued. So, while you probably will have to provide an IRS Form W-9 to get paid if that form is requested, try to head off Form 1099 issues whenever you can.

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