

IRS Forms 1099 Are Coming and 1099-NEC Means Extra Taxes

By Robert W. Wood

It is almost year-end, and with the tax year drawing to a close, IRS Form 1099 season is right around the corner. IRS Forms 1099 should arrive around the end of January 2023 for 2022 payments. These critical tax forms report how much you were paid in the prior calendar year. Some forms can show up as late as April or May, but most come long before.

Forms 1099 can be wrong, so check them carefully. Each Form 1099 is matched to your Social Security Number or your law firm's taxpayer ID Number, so the IRS can easily spew out a tax bill if you fail to report one. Yet what *kind* of payment it is matters. If a client is paying a bill, they might issue a Form 1099-MISC with the amount in Box 3, "other income." That's the most generic income category.

Alternatively, a client paying a bill might issue a Form 1099-NEC, the new form for payments to independent contractors for services. If you receive the new NEC form, it generally means self-employment taxes on top of income taxes. Finally, a client paying a bill might issue a Form 1099-MISC with the amount in Box 10, "gross proceeds paid to an attorney."

Gross proceeds paid to an attorney are not reported as income on the Form 1099, but are instead reported in a special box, Box 10, specifically labeled as "gross proceeds paid to an attorney." Unlike the other boxes on a Form 1099, the IRS does not assume that amounts reported in Box 10 are income. In fact, in my experience, Box 10 reporting rarely results in a tax examination for an attorney who receives Box 10 reporting.

The gross proceeds reporting for payments to lawyers applies even if the law firm is a corporation, overriding the normal Form 1099 rule that you don't have to issue Forms 1099 to a corporation. Of course, whether you receive a Form 1099 for a payment or not, you must report your income, all of it. And if you receive Form 1099-NEC, or a 1099-MISC Box 3 (other income), you should declare it as income. But how about all those big gross proceeds Forms 1099?

What if you are a contingent fee lawyer and get your client a \$1M settlement? Let's say that \$400k is your fee, what should you do? Plainly, you must report your \$400k fee. However, you do not need to report the \$1M and deduct the client \$600k, even though the whole \$1M will likely be reported to you as gross proceeds. You just report your \$400k fee. You don't need to report the \$1M Form 1099 as gross income, since it just reported that you received gross proceeds.

But what about Forms 1099 more generally? Apart from the gross proceeds rule that is unique to lawyers, Forms 1099 generally mean income that must be reported. And if you don't include the reported item on your return, you're almost guaranteed a tax notice. Is it possible that you might not know about a Form 1099? Yes, even if an issuer has your *old address*, the information will be reported to the IRS (and your state tax authority) based on your Social Security Number.

For that reason, it is a good idea to make sure that payers have your correct address so you will get a copy in the mail of all Forms 1099. You can update your address directly with payers, and also put in a forwarding order with the U.S. Post Office. If your tax return filing address has changed, it's also a good idea to file an IRS change of address on Form 8822.

A recent statistic said that the IRS is receiving four billion Forms 1099 a year, and that for 2022 forms issued in January 2023, that number is going up a lot. That may sound like a burden to the IRS, but the IRS likes these forms a lot. After all, they seamlessly allow computer matching of your Social Security Number against your tax return. Businesses issue the forms to anyone who receives \$600 or more for services during the year.

There are many types of 1099. For example, you probably receive a Form 1099-INT for every bank account, even if you only earned \$10 of interest. The most common variety is Form 1099-MISC, for miscellaneous income. On a Form 1099-MISC, the payment should be reported either in Box 3, Other income, or in Box 10, gross proceeds paid to an attorney.

The newest form is Form 1099-NEC, and it covers the waterfront for any independent contractor. The explosion of gig workers means they now have their own 1099 form. Up until 2020, if you were paying an independent contractor, you reported it on Form 1099-MISC, in Box 7, for non-employee compensation. For 2019 and prior years, putting income in Box 7 of a Form 1099-MISC tipped the IRS off that you should be paying self-employment tax too.

Now, use Form 1099-NEC, and if you receive one, remember that self-employment tax can be expensive. It is equivalent to both halves of the employer and employee payroll taxes that apply to wages, which are reported on Form W-2. Self-employment tax can add a whopping 15.3 percent on top of income taxes. That 15.3 percent applies up to the wage base of \$147,000, with 2.9 percent tax on any excess over \$147,000.

Although the NEC form *usually* means self-employment taxes, it doesn't have to if you are not actually self-employed with respect to the income that the form reported. For example, some plaintiffs and whistleblowers receive a Form 1099-NEC when perhaps they should not. The SEC, in particular, has decided that *any* whistleblower who receives a whistleblower award will be issued a Form 1099-NEC.

It is then up to the whistleblower to either pay self-employment tax or to explain to the IRS that they were not self-employed. Of course, the numbers on any Form 1099 are important. If you disagree with the information on the form but can't convince the payer to correct it, explain it on your tax return. If you receive a Form 1099, you can't just ignore it, because the IRS won't. One exception is gross proceeds for lawyers, although you must report any portion of the payment that represents your fees.

Businesses must send out Forms 1099 by January 31, but don't assume that you are off the hook if you don't receive one. Even if you don't receive a Form 1099, you must report all your income, and you don't need a 1099 for that. If the form is issued, the information will be reported to the IRS based on your Social Security number or taxpayer ID number.

Getting a transcript from the IRS is a good idea to track all Forms 1099 issued under your Social Security Number. That way, if a form goes missing in the mail, you will still know. If you forget to report a Form 1099, the IRS will usually send you a computer-generated letter billing you for the taxes. The state may bill you too. On that note, Happy New Year!

Robert W. Wood is a tax lawyer with www.WoodLLP.com, and the author of "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This is not legal advice.