

IRS Income Reporting: It's 1099 Time Again

By Robert W. Wood

If you're like most people, you hate receiving IRS Forms 1099, those little slips of paper reporting income. Issuing them is no fun either. In fact, no one likes Form 1099 except the Internal Revenue Service. IRS computers are whirring to match Forms 1099 against tax returns. Every year, the IRS sends millions of notices based on matching asking for more money. Every other notice or audit activity is tiny by comparison.

Watch out during this special time of year. Generally, businesses must issue the forms to any payee (other than corporations) to which it paid \$600 or more during the year. Although there are many varieties of Form 1099 and many special rules, Form 1099-MISC prompts the most questions and covers the biggest territory. Businesses must send out Form 1099 by Jan. 31 for the prior calendar year. There are penalties on companies issuing them late.

Although the deadline is Jan. 31 for mailing Form 1099 to taxpayers, the payer has until the end of February to send all Forms 1099 to the IRS. This time delay means you may have a chance to correct any errors *before* the payer sends it to the IRS, so open the forms immediately. If the payer has already dispatched the incorrect form to the IRS, ask them to send in a corrected form.



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With computerized matching, every Form 1099 is matched with the payee's return. If you disagree with the form but you can't convince the payer you're right, explain it on your tax return. There's no perfect solution, but if you receive a Form 1099 you can't just ignore it, because the IRS won't. The California Franchise Tax Board will receive all the same information the IRS does. If you miss a Form 1099 on your return, the IRS and the Franchise Tax Board will both follow up.

Keeping payers advised of your current address is a good idea, as is reporting errors to payers. However, if you don't receive a Form 1099 you expect, don't ask for it. If you are expecting a Form 1099, you know about the income. Just report it honestly on your tax return. The IRS computers have no problem with that.

However, if you call or write the payer and ask, "Where is my 1099?" you may be asking for trouble. The payer may issue the form incorrectly. Or you may end up with two of them, one issued in the ordinary course (even if you never received your copy) and a second because you asked! The IRS computer might end up thinking you had twice the income you did.

Lawyers and law firms send as well as receive Form 1099. A payment to a corporation for services is generally exempt. If you pay an individual or LLC court reporter \$1,000, you must issue a Form 1099. If the court reporter is incorporated, none is needed.

However, payments to lawyers and law firms - even incorporated ones - trigger a Form 1099. A lawyer or law firm paying fees to incorporated co-counsel must issue a Form 1099. Any client paying an incorporated law firm more than \$600 in a year must issue this form. If you are a lawyer - even an incorporated one - you will *receive* many Forms 1099 from clients.

But should lawyers *issue* Form 1099 to clients? Practice varies, but most lawyers do not need to issue these forms to their client for settlement monies. Lawyers receiving a joint settlement check to resolve a client lawsuit are usually not considered payers of the money. The settling defendant usually has the obligation to issue the forms, not the lawyer.

Example 1: Larry Lawyer earns a contingent fee by helping Cathy Client sue her bank. The settlement check is payable jointly to Larry and Cathy. If the bank does not know how much each will receive out of this split payment, it must issue two Forms 1099, to both Larry and Cathy, each for the full

amount. When Larry cuts Cathy a check for her share, he need not issue a form.

Example 2: Larry tells the bank to issue two checks, one to Larry for 40 percent, the other to Cathy for 60 percent. Larry has no obligation to issue a form. The bank will issue Larry a Form 1099 for his 40 percent. It will issue Cathy a Form 1099 for 100 percent, including the payment to Larry - even though the bank paid Larry directly. Hopefully Cathy can deduct the legal fee.

The primary circumstance in which lawyers must issue the forms to clients is if the lawyer exercises significant oversight and management over the funds. Under IRS regulations, if lawyers exercise management and oversight of client monies they become payers and can be required to issue Forms 1099 when they disburse funds.

What if you're not sure or make a mistake? The IRS cares a lot about these forms. Most penalties are modest - as small as \$50 per form you fail to file for non-intentional failures. But if you know you must issue a Form 1099 and ignore that obligation, the IRS can slap you with a penalty equal to 10 percent of the amount of the payment. That means a \$400,000 payment for which you fail to issue a required Form 1099 could conceivably trigger a \$40,000 penalty.

As a corollary to Form 1099 rules, attorneys must promptly supply their taxpayer identification numbers to payers required to prepare Forms 1099. Attorneys may often be asked for their own (or their firm's) taxpayer identification number, and that of their client for purposes of reporting settlement monies. Most requests come on IRS Form W-9.

If an attorney fails to provide his taxpayer identification number, the IRS can impose a \$50 penalty for each failure to supply it. The payments could also be subject to back-up withholding, meaning that the defendant could send 30 percent of the money to the IRS. Some defendants may even refuse to disburse settlement monies.

Forms 1099 are a vital part of the IRS' computer matching program, and nearly all of us receive payments reported in this way. Whether you send or receive Forms 1099 or both - and most lawyers should be on the giving and receiving end - pay attention. Take these forms seriously. The IRS and the Franchise Tax Board are both watching.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.