

If You Receive A Request For An IRS Form W-9, What Should You Say?

By Robert W. Wood

Before making a payment, many companies across a wide variety of contexts will ask you for an IRS Form W-9. What is it, and if asked, should you provide it? Can you refuse? A Form W-9 verifies your taxpayer ID number (typically your Social Security Number, or if you are a company, your employer identification number). And if you want to be paid, refusing 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 the payee to sign 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.

Of course, you may disagree that a Form 1099 is appropriate for your payment. Forms 1099 allow computer matching of Social Security numbers and dollar amounts paid and received, so IRS collection efforts are streamlined and automated. Failing to report a Form 1099 on your tax return (or at least explain it) will trigger 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.

Say 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 as a fee. The lawyer is sure to receive a Form 1099 reporting the full \$1 million as gross proceeds. The lawyer need not report the full \$1 million as income, because it is not all income.

In fact, the lawyer can simply 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 in this example will probably receive a Form 1099-MISC (probably in Box 3) for the full \$1 million.

The client must then figure out how to deduct the \$400,000 in legal fees, if that is allowed. Currently, not all legal fees are deductible. Since 2018, it is harder to find a way to claim legal fee deductions in many kinds of cases.

As a result, the little Form 1099 tax forms are pretty important. Can you sidestep the tax reporting by being cagey about your Social Security number or taxpayer ID number? Maybe, but 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.

Usually, the request is 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. Still, the Form W-9 may make you uneasy. A plaintiff in a physical injury case who has just secured the agreement of the defendant *not* to issue a Form 1099 will wonder: why 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. Perhaps this is some kind of know your customer rule, or just good corporate bookkeeping and record-keeping procedures. But on the tax side, companies also like it to show that the payee is a U.S. citizen or resident.

What’s one more reason to sign the form? 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 refusing to hand over a Form W-9 when requested, is subject to backup withholding on the payments.

Thus, 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. If it turns out that the payee is not a U.S. person, so they cannot sign a Form W-9, a Form W-8BEN is the counterpart form for non-U.S. persons that should also satisfy the payee.

Disputes about Forms 1099 are common. The Form 1099 regulations take up hundreds of pages, they are complex and sometimes even conflict with one another. The complexity of the rules probably causes many businesses, and some law firms, 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. Often, you may be able to agree on what forms will be issued and to whom.

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