

Independent contractors puzzle over new IRS Form 1099-NEC

By Robert W. Wood

Taxes and tax filings are unpleasant yet inevitable. We all have to file tax returns and pay taxes, and those obligations will be here before you know it. In 2020, with the onset of COVID and closures everywhere, the IRS gave special dispensation, making the usual April 15 filing and payment deadline for 2019 tax returns July 15, 2020. But it's 2021 now, and it is clear that the April 15 filing deadline this year will not be extended.

Of course, you can go on automatic extension until October 15 if you want. But that is an extension to file your return, not an extension to pay. Therefore, even if you extend until October, you need to pay by April 15 what you expect to owe when you later file your return. If you hope to have an accurate estimate of what to pay by April 15, at a minimum, you need to do some spade work to come up with an accurate figure. After all, if you end up owing more money when you file on October 15, penalties will be added.

One place to begin is IRS Forms 1099, which arrived around the end of January 2021 for 2020 payments. The IRS likes these forms because they allow easy 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 with different thresholds.

For example, you probably received a Form 1099 for every bank account, even if you only earned \$10 of interest. The most common variety of reporting form is Form 1099-MISC, for miscellaneous income. But the newest one in the 1099 series is Form 1099-NEC, and it covers the waterfront for any independent contractor. Over the last decade, there has been a virtual explosion of gig workers, and the result is that they now have their own 1099 form.

Up until 2020, if you were a company paying an independent contractor, you reported the payment on Form 1099-MISC. You put the amount of the payment in Box 7, for non-employee compensation. For 2019 and prior years, putting income in Box 7 of a Form 1099-MISC usually tipped the IRS off that you should be paying self-employment tax too.

However, for 2020 payments, the IRS developed a new form for reporting payments to independent contractors. The new form is IRS Form 1099-NEC. Many lawyers or law firms acting as independent contractors received these forms too. 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.

How expensive? 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 \$137,700, with 2.9 percent tax thereafter on any excess over \$137,700. There's no limit on that 2.9 percent, even if you earn millions. In short, self-employment tax is nothing to sneeze at.

You can read more about Form 1099-NEC for reporting 2020 payments to independent contractors on the IRS website, or on the detailed IRS instructions for Form 1099-NEC. Now that independent contractors have their own unique form of Form 1099, what happened to Form 1099-MISC? Box 7 of the old form was essentially made into a whole new form for independent contractors.

Form 1099-MISC is still with us and is still widely used. However, for 2020 and subsequent-year payments, the available choices on Form 1099-MISC are more limited. Most payments are recorded in Box 3, as "other income." Other income is the most general of categories, and is still probably the default category for payments. However, saying "other income" makes it likely that the IRS would not assume that self-employment taxes should apply.

Indeed, a move to try to collect more self-employment taxes seems to have been the major impetus behind the IRS creating Form 1099-NEC. In the past, too many companies reported payments to independent contractors as "other income" (Box 3 of old Form 1099-MISC) rather than as non-employee compensation (Box 7 of old Form 1099-MISC). Now, any payment reported on Form 1099-NEC will presumptively trigger self-employment tax.

Of course, errors and disputes about Forms 1099 occur. If there is an error on a Form 1099 tell the payer immediately. There may be time for the payer to correct it. If the payer has already dispatched the incorrect form to the IRS, ask the payer to send in a corrected form. You can try to convince the company that your figures are correct and ask them to correct it. However, if you cannot convince the payer that you are right and to correct it, you will need to explain it on your tax return.

If you receive a Form 1099, you cannot just ignore it. The IRS will expect to see the payment reported on your tax return. If you fail to report it, the IRS will send you a tax notice. What if your Form 1099 is lost in the mail? Many people move, so many Forms 1099 go missing. Even if you don't receive a Form 1099, you must report all your income, and the IRS says you don't need a Form 1099 for that.

However, if the form is issued, the information will be reported to the IRS based on your Social Security number, regardless of whether you receive your copy of the form in the mail. Update your address directly with payers, and put a forwarding order in with the U.S. Post Office. A good cross check is to order a transcript from the IRS. A transcript should list all Forms 1099 issued under your Social Security Number, even if you don't receive copies in the mail.

If you forget to report a Form 1099, the IRS usually sends a computer-generated letter or notice billing you for the taxes. Most states also have an income tax, and they will receive the same information as the IRS. If you missed a Form 1099 on your federal income tax return, your state will probably bill you too.

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