

Should Lawyers and Clients Provide an IRS Form W-9 When Asked?

By Robert W. Wood

Before paying you for services rendered, and before paying a legal settlement, many companies will ask for an IRS Form W-9. A Form W-9 verifies your taxpayer ID number. In the case of individuals, it is your Social Security Number, and if you are a company, your employer identification number. If you want to be paid, refusing to hand over a Form 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. Of course, gross income is not the same thing as taxable income. Often, a Form 1099 will report amounts that are one but not the other.

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. 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 how to deduct the \$400,000 in legal fees. It is been harder to find a way to claim legal fee deductions in some cases since 2018. But in my experience, it is still almost always possible to support a tax deduction. I have never seen a client actually have to pay taxes on the legal fee portion of an award.

Of course, clients worry about the gross income, and no one especially likes receiving a Form 1099 for \$1M when they only see \$600,000. In that sense, what goes on the Form 1099 is important, bringing us back to IRS Form W-9. 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? In most cases, 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, for many taxpayers, handing over a 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 a 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. That can be one reason why some companies insist on the form, even if the settlement agreement states that they will not issue an IRS Form 1099 to the plaintiff. The biggest reasons to provide the form are to get paid, and to avoid backup withholding. However, there might be another reason too.

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. 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. Often, you may be able to agree on what forms will be issued and to whom.

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