

What Lawyers Should Know About IRS Form 1099

By Robert W. Wood

An IRS Form 1099 reminds you that you have to pay tax. You probably don't like receiving the forms, and if you're in business, you probably don't especially like sending out the forms either. The forms can prompt calls and complaints from recipients saying the information is wrong, they didn't receive the payment, the form should not have been issued for this kind of payment, and so on.

But millions of Forms 1099 are sent out every year, and the IRS relies heavy on them, allowing IRS computers to easily keep tabs on millions of payments. Even though the IRS audits a tiny fraction of returns, the IRS matches nearly all Forms 1099 against your Form 1040, sending automated notices to pay up. Here are some facts you should know.

You Don't Need a Form 1099

If you know about the payment, you don't need the form. There is no mismatch on your tax return if you report a payment but didn't receive a Form 1099. Only the reverse is a problem. Even so, keeping payers advised of your current address is a good idea, as is reporting errors to payers. But that's where I'd stop.

If you don't receive a Form 1099 that you expect, don't ask for it. If you are expecting a Form 1099, you know about the income, so just report that amount on your tax return. The IRS computers have no problem with that. Besides, if you call or write the payer, you may end up with two forms, one issued in the ordinary course (even if it never got to you) and one issued because you called. The IRS computer might end up thinking you had twice the income you really did.

Not Every Payment Triggers a Form 1099

The basic Form 1099 rule is that each person engaged in business and making a payment of \$600 or more for services must report it on a Form 1099. The rule is cumulative, so while one payment of \$500 wouldn't trigger the rule, two payments of \$500 to a single payee during the year require a Form 1099 for the full \$1,000.

Generally, businesses must issue the forms to any payee (other than a corporation) who receives \$600 or more during the year. And that's just the basic threshold rule; there are many, many exceptions. That's why you probably get a Form 1099 for every bank account you have, even if you earned only \$10 of interest income.

There are Different 1099s

There are many varieties of 1099. There's a 1099-INT for interest; 1099-DIV for dividends; 1099-G for state and local tax refunds and unemployment benefits; 1099-R for pensions and payouts from your individual retirement accounts; 1099-B for broker transactions and barter exchanges; 1099-S for real estate transactions, etc. In fact, there's a dizzying array. There are many categories, but the Form 1099-MISC (for miscellaneous) seems to prompt the most questions and covers the biggest territory. And the newest 1099 is Form 1099-NEC for payments to independent contractors.

You Can Report Errors

Reporting errors is wise, so don't just put arriving 1099s in a pile, open them immediately. Suppose you get a 1099-MISC reporting \$8,000 of pay, when you know you received only \$800? Tell the payer immediately. There's a special box on the form to show it is correcting a prior 1099—so the IRS doesn't just add the amounts together. The corrected form will cancel the first one. Besides, even if the payer doesn't fix it for you, keep a copy of your correspondence. It might help you convince the IRS you only got \$800.

Beware Forms 1099-MISC and 1099-NEC

Form 1099-NEC is specifically for paying independent contractors, so do not use Form 1099-MISC for that purpose: Use Form 1099-NEC instead. The NEC form tips of the IRS they should get self-employment tax on top of income tax. Self-employment tax 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 thereafter on any excess over the wage base. There's no limit on that 2.9 percent, even if you earn millions. In short, self-employment tax is nothing to sneeze at.

A Form 1099-MISC is more neutral, just reporting income, but not saying it is subject to self-employment tax. Box 3 of MISC is the big one, "other income." Before 2020, there was Box 3 and Box 7 for non-employee compensation—but now Box 7 was made into its own form, Form 1099-NEC.

Lawyers Receive Many Forms 1099

Lawyers are singled out, and most payments to a lawyer are supposed to be reported, even the client's money. Case settlement proceeds too. Say that a lawyer settles a case for, with payment to the lawyer's trust account. Even if the lawyer splits 60/40 with the client, the lawyer gets a 1099 for 100 percent. But lawyers get a break, they received 1099-MISC box 10, "gross proceeds paid to an attorney." It is a special box only for lawyers, and unlike other 1099s, it does not count as income.

But apart from the very good deal that gross proceeds reporting is for lawyers, in other ways lawyers are disadvantaged when it comes to Forms 1099. Lawyers receive and send more Forms 1099 than most people, in part because of tax laws that single them out. Lawyers must issue Forms 1099 to expert witnesses, jury consultants, investigators, and even to co-counsel if the payment is \$600 or more.

Moreover, any client paying a law firm more than \$600 in a year as part of the client's business must also issue a Form 1099. It applies to law corporations too, even though corporations are exempt from receiving 1099s. Lawyers are singled out.

Mailing Address vs. Taxpayer ID Number

Regardless of whether the form has your correct address, the information will be reported to the IRS (and the state) based on your Social Security or taxpayer ID number. But you want to see any forms that are issued, and that means by mail, so you have an interest in making sure that payers have your correct address. Update your address directly with payers, as well as putting a forwarding order in with the U.S. Post Office. You'll want to see any forms the IRS sees. It is important knowledge, don't let it go to waste.

Don't Ignore Forms 1099

Every Form 1099 includes the payer's employer identification number and the payee's Social Security (or taxpayer identification) number. The IRS matches the 1099 with the payee's tax return. If you disagree with the information on the form but you can't convince the payer you're right, explain it on your tax return. Suppose you received a \$100,000 payment from your car insurance company to cover your medical expenses and pain from whiplash you suffered in an accident.

A payment for personal physical injuries is excludable from income, and it shouldn't be the subject of a Form 1099. If you haven't succeeded in convincing your insurance company to cancel the 1099, try to explain it on your tax return. There's no perfect solution, but one thing is clear: If you receive a Form 1099, you can't just ignore it, because the IRS won't.

If you forget to report the \$300 of interest you earned on a bank account or the \$6,000 consulting payment you received, the IRS will send you a computer-generated letter billing you for the tax due. The IRS may not "audit" many people, but these notices are low hanging fruit and the IRS usually collects.

Forms 1099 Can Arrive Year Round

Businesses must send out Forms 1099 by January 31 each year for the prior calendar year. But some businesses send a Form 1099 at the same time they send you a check, so they won't have to send you a form later. That means you might receive a Form 1099 any time. Besides, some companies are late, so don't assume you're off the hook if you don't receive a Form 1099, even by March or April. Even May is not unheard of, so keep a lookout for Forms 1099 any time. When they arrive, open and check them, and then put them in a safe place.

California Gets a Copy Too

Most states have the same kind of computer matching program as the IRS. That way, your state can spew out an automatic tax bill if you fail to report a Form 1099 on your state tax return. Most states have an income tax, and they will receive all the same information the IRS does. So if you failed to report a Form 1099 on your federal tax return, that your state tax man will probably catch up with it, too.

Conclusion

Forms 1099 are a vital part of the IRS's computer matching program, and nearly all of us receive payments reported in this way. Take these forms seriously. I assure you the IRS does.

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