

Will The IRS Even Know Whether You Received A Form 1099

By Robert W. Wood

Year end is coming, and it isn't too early to start thinking about IRS Forms 1099. If you practice law in a law firm or in-house with a company, it might pay to start thinking about how many of the little forms you, your firm or company will need to send out. Co-counsel, experts, independent contractors, consultants, they all may require a form if you've paid them \$600 or more during 2021. And regardless of where you work or how you do it, you should start thinking about how many of the little forms you personally are likely to receive in the mail come January.

These tax forms arrive in late January or early February, and report how much you were paid during the prior calendar year. Don't ignore them; each one includes your Social Security number or your law firm's Employer Identification Number. In general, each form will be matched against your tax return. What if you earned income but the person who paid you forgets to issue you a form? It reminds me of that old puzzler, "If a tree falls in a forest and no one is around to hear it, does it make a sound?"

So if you do not receive a Form 1099 for a payment, is it income in the first place? And can you argue that since there was no form, it must not be taxable? Besides, how will the IRS know? These questions come up more frequently than you might think, and it might be tempting to play dumb. But that's not wise, even if you don't receive a form.

It's worth noting that virtually any payment to a lawyer or law firm is subject to special Form 1099 reporting. That is courtesy to a special tax code section in effect since the 1990s, and Treasury Regulations to boot. The Form 1099 rules for lawyers trump many other Form 1099 rules, including the rule that corporations generally don't need to be issued IRS Forms 1099. You guessed it, incorporated law firms still must be issued Forms 1099. It doesn't even matter if the payment to the law firm is income in whole or in part, such as a payment for services. For example, if your firm is sent money for a real estate closing that you will simply pass along to the title company, a Form 1099 will still be issued to your firm. We'll come back to the significance of this after covering some basics.

Forms 1099 can have errors, so check each one carefully. If you were paid \$10,000 but the Form 1099 says \$100,000, contact the issuer. If you can't get them to fix it, you'll need to disclose and explain the \$100,000 on your tax return. IRS Forms 1099 remind you that you earned interest, received a consulting fee, or were paid some other kind of income. They notify the IRS too. But say you earned \$50,000 from someone but they forgot to send you the form?

Can you ignore a payment that is not reported on a Form 1099, the tree falling in the forest that no one hears? Not really. The IRS say that income is income, whether you receive a Form 1099 or not. In fact, all sorts of payments are taxable, even though there is no requirement for a Form 1099 to be issued. In general, if you receive a Form 1099 and do not

include the reported item on your tax return, you can expect an IRS notice or bill. Each Form 1099 is matched to your Social Security number, so the IRS can easily churn out a tax bill if you fail to report one.

In fact, you're almost guaranteed an IRS tax notice if you fail to report a Form 1099. What if you've moved and the form never catches up with you? Even if it is sent to your *old* address, the information will be reported to the IRS (and your state tax authority) based on your Social Security number.

It is a good idea to make sure payers have your correct address so you get a copy. Update your address with payers, and also put in a forwarding order with the U.S. Post Office. If you move, it's also a good idea to file an IRS change of address Form 8822. Let's return to the question whether not receiving a Form 1099 allows you to argue that means that the payer thought it was nontaxable.

Some people have tried this argument. When it comes to legal settlements, the IRS says that the payor's intent is a key indicator how it should be taxed. Often, the character of a settlement payment hinges on the dominant reason of the payor in making the payment. Courts have determined the payor's intent by examining the entire record, including whether a Form 1099 was issued.

Nevertheless, a payor's failure to issue a Form 1099 alone is not conclusive proof that a payment is not subject to tax. People in reported tax cases have made this argument with the IRS, and even in Tax Court. It hasn't worked so far. Whether a Form 1099 should have been issued or not, the question is, is it income? Unlike Forms W-2, you don't file Forms 1099 with your return.

Usually, if know about your payment, you don't really need the form. An alternative to asking an issuer for a Form 1099 is to get a transcript of your account from the IRS. It should show all Forms 1099 issued under your Social Security number. That is better than asking for a Form 1099, especially for something like a lawsuit recovery. Besides, getting a transcript is a useful way to double check your information.

In general, a business taxpayer that makes a payment of \$600 or more to another taxpayer must file a Form 1099. There are different kinds, the two most common being Form 1099-MISC, and Form 1099-NEC for independent contractors. Forms 1099 come in many varieties, including 1099-INT for interest, 1099-DIV for dividends, 1099-G for tax refunds, 1099-R for pensions, and 1099-MISC for miscellaneous income. Newest of all is new Form 1099-NEC for independent contractors.

Use new Form 1099-NEC for consulting payments and any other form of payment to an independent contractor. Even if you pay someone in crypto, if the pay for the year is worth \$600 or more, you must issue the form, reporting the value of the crypto on the day you paid it. Of course, with the millions of Forms 1099 being issued, mistakes occur.

If you receive a form that includes the wrong dollar amount, you can ask the issuer to correct it, and there are several ways of making a correction. The issuer can destroy

the incorrect one if they have not already sent a copy to the IRS. If they have already sent a copy to the IRS, they can issue a corrected Form 1099. A corrected Form 1099 will supersede the incorrect one.

Unfortunately, there are many judgment calls that companies must make when issuing Forms 1099. For example, most lawsuit settlements are reported, and in many cases the tax rules are not clear. If you settled a suit and received taxable damages, report the payment as income. But if you have arguments that the lawsuit recovery should not be taxable, the last thing you want is a Form 1099. Some damages are tax-free under Section 104 of the tax code, but only physical injuries and physical sickness qualify. If a plaintiff receives a Form 1099, they can still argue it is not taxable, but that can be an uphill battle. And since 2018, in some lawsuit settlements, legal fees can't be deducted.

Is there any good news in all of this? For lawyers, the best news may be the specific type of Form 1099 they are likely to receive. In most cases, lawyers receive a Form 1099-MISC, with the amount reported in Box 10, as gross proceeds paid to an attorney. This box is only for reporting payments to lawyers. Why is the gross proceeds paid to an attorney category so important?

For one thing, gross proceeds reporting for lawyers is not counted as income to the lawyer. In other words, gross proceeds reporting for lawyers is an exception to the normal rule that amounts on a Form 1099 are automatically counted as income. Any payment to a lawyer is supposed to be reported, even if it's entirely the client's money. Case settlement proceeds count as gross proceeds, too.

Say that a lawyer settles a case for \$1 million, with payment to the lawyer's trust account. Let's assume that 60% is for the client and 40% 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 gross income, because it is not all income. The lawyer can simply report the \$400,000 fee as income without worrying about computer matching, since gross proceeds do not count as income.

The client isn't so lucky. Unless the settlement is compensatory damages for personal physical injuries or a capital recovery, the client will receive a Form 1099-MISC (probably in Box 3, "other income") for the full \$1 million. There are thus two Forms 1099 issued for the full \$1 million, one to client, one to lawyer. The client must then figure out how to deduct the \$400,000 in legal fees. Not all legal fees are deductible, and it is harder to find a way to claim them in many kinds of cases since 2018.

In some 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. However, lawyers are the beneficiaries of gross proceeds reporting, since gross proceeds are not tracked as income by the IRS the way other boxes on a Form 1099 are tracked.

That can be a double-edged sword. It might tempt you to think that some of those gross proceeds payments are not income to you or to your law firm. Sometimes, a business client paying your bill might issue you a Form 1099-MISC, reporting in Box 3, as other income. That would be correct reporting, and would be tracked as income, because it is.

On the other hand, the client might issue you a Form 1099-MISC, reporting in Box 10, as gross proceeds paid to an attorney. Many payments to lawyers are reported this way, even if it is clear that they are 100% in payment of an invoice (which technically should mean Box 3). So whatever type of

Forms 1099 you receive, be careful to determine what is income and how it should be reported.

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