

Lawyers and IRS Form 1099: Better to give than receive?

By Robert W. Wood

Lawyers and law firms send as well as receive Forms 1099. But lawyers don't always have to issue them, especially to clients. Nevertheless, the Internal Revenue Service will hardly criticize you for issuing more of the ubiquitous little forms. In fact, in the IRS' view, the more Forms 1099 the better. Forms 1099, which are issued in January for the preceding calendar year, report payments to taxpayers — with a copy to the IRS.

Why does the IRS love them? They allow computer matching of Social Security numbers. IRS statistics show that when you receive one of these forms, you are much more likely to report a payment on your tax return. That should be no surprise. And it takes no effort for the IRS to spew out a tax bill if you fail to include on your return a payment reported on a Form 1099.

Requirements to issue Forms 1099 have existed in the tax code (and parallel state law) for decades. However, these requirements have become more rigorous in recent years. Penalty enforcement has also gotten tougher. More and more tax reporting is now required, and lawyers and law firms are facing this as well.



Robert W. Wood is a tax lawyer with a nationwide practice (www.WoodLLP.com). The author of more than 30 books including "Taxation of Damage Awards & Settlement Payments" (4th Ed. 2009 www.taxinstitute.com), he can be reached at wood@WoodLLP.com.

The basic reporting rule is that each person paying \$600 or more in the course of operating a business (for services and many other items) must report it on a Form 1099. That means lawyers must issue a Form 1099 to an expert witness, jury consultant, investigator or co-counsel where services are performed and the payment is \$600 or more. Payments during the year are aggregated. If you pay an investigator \$500 and then another \$500 later the same year, you must issue a Form 1099.

A notable exception to these rules is for payments to corporations. A payment to a corporation for services is generally exempt. That means if you pay an individual court reporter \$1,000, you must issue a Form 1099. If the court reporter is incorporated, the form is not needed.

However, there's an exception to the exception for payments to lawyers and law firms. Even payments for services to incorporated law firms trigger a Form 1099. So a lawyer or law firm paying fees to incorporated co-counsel, or a referral fee to an incorporated lawyer, must issue a Form 1099. It also means any client paying an incorporated law firm more than \$600 in a year must issue a Form 1099. If you are a lawyer — even an incorporated one — you will *receive* many Forms 1099 from clients.

Should lawyers even *issue* Forms 1099 to clients? Practice varies, but most lawyers do not need to issue a Form 1099 to their client for settlement monies. The reason is that lawyers receiving a joint settlement check to resolve a client lawsuit are usually not considered payors of the money. The settling *defendant* has the obligation to issue the forms, not the lawyer.

Take this example: Larry Lawyer earns a contingent fee by helping Cathy Client sue her bank. The settlement check is payable jointly to Larry and Cathy. If the bank doesn't know about this payment split, it must issue a Form 1099 to Larry and one to Cathy, each for the full amount. When Larry cuts Cathy a check for her share, he need not issue a form.

Now take this example: Suppose Larry tells the bank to issue two checks, one to Larry for 40 percent, the other to Cathy for 60 percent. Obviously, again Larry has no obligation to issue a form — Cathy is getting paid by the bank. The bank will issue Larry a Form 1099 for his 40 percent. It will issue Cathy a Form 1099 for 100 percent, including the payment to Larry

— even though the bank paid Larry directly. Cathy will have to find a way to deduct the legal fee.

The primary circumstance in which lawyers must issue the forms to clients is if the lawyer exercises significant oversight and management. Under IRS regulations, if lawyers exercise management and oversight of client monies they become payors and can be required to issue Forms 1099 when they disburse funds.

What if you're not sure or make a mistake? The IRS cares a lot about these forms. Most penalties are modest — as small as \$50 per form you fail to file and your error was not intentional. But in some cases, if you fail to issue a required Form 1099, the IRS will try to deny a deduction for the item that should have been reported. That means if you fail to issue a Form 1099 for a \$100,000 consulting fee, the IRS could claim it is non-deductible.

Another danger is the penalty for *intentional* violations. If you know you must issue a Form 1099 but ignore that obligation, the IRS can slap you with a penalty equal to 10 percent of the amount of the payment. That means a \$400,000 payment for which you fail to issue a required Form 1099 could trigger a \$40,000 penalty.

Finally, these rules can impact the worker status arena too. If you fail to issue Forms 1099 to jury consultants or contract lawyers, whom you have paid on an independent contractor basis, the IRS can use that failure as evidence that they are *really* your employees. This can bring tax withholding responsibilities and a whole host of other penalties.

As a corollary to Form 1099 rules, attorneys must promptly supply their taxpayer identification numbers to persons who are required to prepare these forms. Attorneys may often be asked for their own (or their firm's) taxpayer identification number, and that of their client, for purposes of reporting settlement monies. Most requests come on IRS Form W-9.

If an attorney fails to provide the taxpayer identification number to a paying party, the IRS can impose a \$50 penalty for each failure to supply that information. The payments could also be subject to back-up withholding, meaning that the defendant could send 30 percent of the money to the IRS. Moreover, some defendants may refuse to disburse settlement monies without your taxpayer identification number.

No one likes receiving Forms 1099. Most people don't particularly like issuing them either. Still, pay attention to these rules. Especially if you get into a tax dispute, you'll be glad you did.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.