

How to fix IRS Form 1099 reporting errors

By Robert W. Wood

Most people receive Forms 1099 every year, a kind of gentle reminder about payments we received during the year. These little reminders to pay your taxes are critical to the IRS information return matching program, making it very easy for the IRS to send out tax notices to collect additional taxes if your tax returns and Forms 1099 seem to be off base, a process that seems to be ever more automated. Information reporting has become a centerpiece of IRS enforcement efforts for decades, arguably even more so now.

Generally, businesses must issue the forms to any payee (other than a corporation) who receives \$600 or more during the year. That's just the basic threshold rule, and there are many exceptions and special rules. 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'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, and so on.

In fact, there's a dizzying array. But two forms seem to prompt the most questions and cover the biggest territory. First there is Form 1099-MISC (for miscellaneous). Lawyers see these a lot and so do their clients. The two boxes on the form where dollar amounts go are box 3, for other income, and box 10 for gross proceeds paid to an attorney. Any payment reported to lawyers in box 10 does not mean it is income to the lawyer. All of it may be income, some of it may be income, or none of it may be income, it depends on the facts. And unlike money that is reported in Box 3, the IRS does not match Box 10 reporting to tax returns.

The second major form is Form 1099-NEC, which stands for non-employee compensation. That form is supposed to tip off the IRS that they should be collecting self-employment tax in addition to income tax. If an independent contractor lawyer is being paid for services, that should be reported on a Form 1099-NEC, not as gross proceeds on a Form 1099-MISC. Some defendants report money to plaintiffs on Form 1099-NEC when they should report it on Form 1099-MISC, so it pays to be specific in settlement agreements. No one likes to be surprised in January by tax forms that you do not expect.

What happens if you or your client receive a tax form that is wrong? Incorrect IRS Forms 1099 are a big tax worry. After all, Forms 1099 generally saddle you with income you need to report. Of course, if you have income, you must report it, whether or not you receive a Form 1099. But think of the Form 1099 as a strong nudge in case you forgot about a payment. If you receive many small payments from one source during the year, they can be aggregated on a single Form 1099.

Seeing the dollars reported to your Social Security number can be chilling, especially if you think it's wrong and way more money than you actually received. So suppose you receive a Form 1099 that you know to be wrong? Say you were paid a consulting fee of \$30,000 in 2024, but the 1099 you receive in January 2025 is for 10 times that, \$300,000? What

should you do? First, act promptly. You may be able to approach the issuer, show you really only were paid \$30,000, and get the issuer to reissue it correctly.

Ask issuer to correct incorrect Form 1099

If you call and write the issuer of the incorrect Form 1099 as soon as you receive it, the issuer may be able to destroy the incorrect one and issue a new form even before the IRS copy of the form has been dispatched. If you follow this path, keep a written record. Ask for a letter from the company saying that it erroneously issued a Form 1099 for \$300,000, destroyed it, and then properly issued one for \$30,000. Why keep this?

Because you may find that the company transmitted the incorrect Form 1099 to the IRS after all. This way, you'll be able to explain it. But most of the time when you say "my 1099 is wrong" the IRS already has it. So if the issuer of the Form 1099 has already sent it to the IRS, ask for a "corrected" Form 1099. The issuer will prepare a Form 1099 in the correct amount and check a "corrected" box on the form.

The corrected form is supposed to cancel out the first one in the IRS system, once you give it time to settle. But what happens if the issuer won't cooperate at all, or you can't convince them that your numbers are right and theirs are wrong?

Explain incorrect Form 1099 on your tax return

There's no good answer. You'll need to address this on your return. For example, you could show the \$300,000 payment on your return (on line 21, or on a Schedule C), and then explain the \$270,000 overstatement. You could do so in a statement or footnote by showing \$30,000 on line 21, but adding "see statement." The statement might say:

| |
|-----------------------------------|
| Erroneous Form 1099-NEC \$300,000 |
| Less error amount \$270,000 |
| Net to line 21 \$30,000 |

Beware of higher audit risk

Does this make your audit risk higher? It may, and that's an argument for doing all you can to make sure that the Form 1099 is correct in the first place. But you probably don't have much choice. After all, you practically guarantee an audit if you merely report the \$30,000 figure and don't explain. In that event, the IRS will likely send you a notice asking for tax on the missing \$270,000.

If you are really miffed, you could try to sue the payor for issuing an erroneous Form 1099. However, most such lawsuits go nowhere and are expensive. It is usually possible for a payor to justify almost any reporting they have done, and the courts are usually reluctant to get involved. And forget trying to bring the IRS into your dispute; it will not join disputes with private parties. Besides, you won't have the suit concluded before the deadline for filing your tax return.

The difficulties faced by taxpayers who receive incorrect Forms 1099 are one reason to be as specific as possible in written agreements so that the amount, type and number of Forms 1099 are explicit. If you are settling a

lawsuit, the settlement agreement should be specific about each Form 1099 that will be sent. If you are settling litigation, just be aware that the IRS generally assumes that most lawsuit settlements are taxable and that the exact wording of a settlement agreement matters.

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