

1099 Questions

It's that time of year, 1099s are pouring in from from places unknown. Some questions/concerns that I was hoping people would be willing to help out with. Any insight would be greatly appreciated. If you have additional frustrations related to 1099s, feel free to chime in.

1. Client wrote that he has paid me \$X amount. However, this is only the amount that has been deposited into my client trust account. The amount that I have disbursed is much, much smaller than that. What to do?

2. I got a 1099 from some LLC I have never heard of in my life. After a google search, turns out it's a former client's LLC. I helped him with a matter totally unrelated to the LLC. Should I be concerned?

These might be elementary questions for some of, but I greatly appreciate insights. Also, I would greatly appreciate any pointers regarding a system you may have developed for dealing with 1099s.

Ok, For 1. You need to tell the client that he need to file a corrected 1099. He's trying to over state his expenses and cheat the income tax people and screw you in the process. For 2, is that the amount of income from that client? If so he's not screwing you but he's trying to assign the expense to another entity for taxes purposes. This client is just screwing with the IRS. Might call and ask him why.

John Davidson, Pennsylvania

Good thing it's already a former client....

Tim Ackerman

Technically speaking, you are a cash basis taxpayer, and all payments you receive are income when received - including retainers. Now, that said...

The IRS is aware of retainers, and will audit them appropriately. Your client, however, may not be aware that a retainer payment is not the same as a normal payment that is income. So your client, or his CPA, simply followed the basic rule: over \$600 = 1099.

If your client paid you less than \$600 of earned fees, then he'll have to issue a corrected 1099 with a \$0 balance. Otherwise, he'll have to issue one with the correct amount earned. Either way, a corrected 1099 is needed.

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OTOH, some will argue that as long as your reported income > your 1099 income, it doesn't matter. That works, unless you're audited and have to hand over the 1099s. The IRS will notice the discrepancy, and ask about it, so it's better to memorialize the issue (in case the ex-client doesn't issue a new 1099) than ignore it.

As for #2, if the LLC is a SMLLC, it's inappropriate, but ultimately a minor issue for you - more of an issue for the ex-client, who's attempting to dodge SE tax. If not, then the client's engaging in fraudulent behavior. Write to the client, explain the issue and request a correction. That way, you've done what you can to inform the client of their improper behavior. Be sure to properly record the income, but don't worry too much about the source.

Greg Zbylut, California

Hmmm. Not so sure I agree with you there. Is depositing in a client funds (trust) account receipt of income? Suppose Client gives Attorney a \$10,000 retainer in December, 2012 for Attorney to start a case, and Attorney bills Client \$2,000 on January 1, 2013, taking the income from the retainer. Attorney should have zero income from Client in 2012, and \$2,000 in 2013. IRS audits Attorney, and claims Attorney should have recognized \$10,000 income in 2012?

According to the IRS Audit Manual, yes:

<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Attorneys-Audit-Technique-Guide---Chapter-3#ch3-client>

According to an article titled "Tax Traps for Lawyers" from the ABA, no:

http://www.americanbar.org/newsletter/publications/gp_solo_magazine_home/gp_solo_magazine_index/su96boot.html

From an online discussion:

Depends on what your definition of "retainer" is.

A true "retainer" is treated as CrowJD states, non-refundable and earned when received. Typically in consideration for the attorney's availability to the client. Fees for services rendered would be different income.

If the "retainer" is refundable, it is probably really a deposit (but often called a "retainer"). A client may make a deposit for the purpose of paying future legal fees. That deposit is the client's money until it is earned by the attorney. The attorney is a custodian

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of the money until it has been earned. So, until that time (earned) it is not treated as income.

I do not accept nonrefundable retainers, so I suppose in my case they're not really retainers, but deposits. It would be interesting to see an actual Reg on the subject.

Michael A. Koenecke, Texas

I beg to differ. I also recognize this is a question of terminology.

The State of North Carolina is quite clear that "retainers" - as in unearned advance deposits toward fees held in trust - are NOT my money, are WILL NOT BE mine until they are earned. Money held in trust is fully refundable, and in fact, we're required to periodically confirm with clients whether they wish for us to continue to hold it after a certain period of time. I suspect the IRS sees likewise.

"Retainers" has two meanings: Advance payment held in trust, and retainer fees charged for "priority" in scheduling, etc. Some states count them as earned when paid, and don't want them in the trust account. North Carolina distinguishes deposits to trust - frequently *called* retainers - from such fees.

My trust account is carefully tracked and audited, but it has absolutely nothing to do with my earnings, and in no way and at no time does anything in my trust account appear in my accounting, for tax purposes or otherwise.

-Rick

Richard J. Rutledge, Jr., North Carolina

As a follow-up to what Greg said, what if in Dec. 2012 a client writes and sends a \$500 check to my firm, a cash basis taxpayer, but I don't receive it until 2013? The client includes the \$500 on a 1099, but don't I count the \$500 as income for 2013? Thanks!

Tracia Y. Lee, Texas

It's my understanding that the difference between cash and accrual accounting is that under the cash accounting method, you consider the payment income only when received. Under accrual, you count it when it becomes due.

Michael Jack Kaczynski, Connecticut

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I'm glad to see that you only had TWO questions. From your subject line, I got the impression that you had a lot more than that. ;-)

Okay, other than my stupid joke, I'll just say that I agree with Greg Zbylut.

Cheers,

David Allen Hiersekorn, California

Ok, I looked this up in the IRS regs and both David and Greg are correct. Seems a bit unfair, but who am I? So, what happens when I return the remainder of that deposit? I'm still slightly confused by this.

Ryan Young, Virginia

One approach is to track and total them, but assuming they are less than actual cash income, put actual cash income into return and ignore issue for federal tax purposes. If 1099s exceed actual cash income, then a report or schedule or explanation is in order. Presumably the difference would be the difference between retainers and income, if applicable. Another common issue arises if a case was contingency, depending on how the case was settled and reported, where I have seen the whole settlement amount reported on law firm 1099 (probably erroneous, but may require explanation). Of course, if you are on an accrual basis (probably rare on this listserve), different rules apply.

Darrell G. Stewart, Texas

Do all the people who are supposed to issue a 1099 to you issue them each year? In my experience, attorneys I've worked for have to be asked for it and even then some just do not issue them to me. I keep good records and don't expect to ever have a problem. But, it is an annoyance to me to have someone paying me and not providing me with the 1099.

In your case, had the client not sent you the 1099 you would have had no way of knowing what he did until (potentially) after you had a problem with the IRS. Wouldn't that be a good reason to pester clients to issue them to you if they fail to do so?

We used to use a different tax preparer than our current one. She said not to be concerned about not getting 1099s, but said I needed to at least have the attorneys' tax IDs. I have no idea where that comes in, but she went

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attorney by attorney as she processed my return. The one we use now says that is not necessary.

Donna R. Ireland, New Jersey (not a lawyer)

What is of more concern to me is when you have a large referral fee to pay to an attorney. If you don't 1099 them, the IRS assumes you took the entire fee.

Bobby Lott

The tax preparer you use now is correct - you don't need the TINs of the attorneys who paid you. They, however, need yours to issue the 1099.

Failure to issue a 1099 that should have been issued subjects the party who should have issued to a \$150 per 1099 penalty (it was \$50 for years, but has recently gone up). That can get pricey, so more people are likely to comply than formerly when they'd blow it off (heck if you only have two, what's \$100? But \$300...).

The fact is, a lot of people don't issue 1099s when they should out of ignorance. Some don't realize they paid you that much, some assume you don't have to get one ... the reasons are endless.

As Darrell said, make sure the income you report is > the income reported on 1099s, and you'll be fine.

Greg Zbylut

Talking about 1099s, in a personal injury practice, my understanding was that one doesn't have to 1099 the client. Is that true at all?

Rod Alcidonis, Pennsylvania

That's correct, because the proceeds aren't typically taxable to the client, just to the attorney(s).

Bobby Lott

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I've represented a couple of corporations. Only one sent a 1099 the other stiffed me on part of the fee.

So it's rare that I get more than 1 or 2 and those seldom total more than 5% of my income.

John Davidson

I received a 1099 recently for a payoff based on a claim against a commercial liability policy (a medical supply company that bills Medicare that is currently going through a bankruptcy). At any rate a claims management company handled the claim and we settled. This was my first PI case btw, done on a 1/3 contingency fee agreement. Side note...cases that have to deal with paying back Medicare is a royal PITA...ok enough venting.

I received the settlement funds, deposited the funds into the trust account, then cut checks for client (2/3) and 1/3 for myself. The damn 1099 however is reporting the full amount however in my name. I'm not sure how to work this out when I do my taxes. I don't want an audit (hell who would?).

Advice?

Ronald Flores, Alabama

That is how it always is. When you issue a 1099, there is a spot for attorneys fees.

Just report the amount you actually receive.

Bobby Lott

Yes, when I get a settlement check I'll send 1099's off to the doctor's I paid off. Then I report the income that is mine.

It's all you can do. The IRS comes to audit me, they'll see I reported all of my income.

Joseph D. Dang, California

From the IRS instructions for Schedule C:

"Line 1

Enter gross receipts from your trade or business. Include amounts you received in your trade or business that were properly shown on Forms 1099-MISC. If the total amounts that were reported in box 7 of Forms 1099-MISC are more than the total you are reporting on line 1, attach a statement explaining the difference."

You received a 1099 because someone sent you \$600 or more. They represent some of your gross receipts. Sometimes the money received as represented by the 1099 is income to you, sometimes not.

My practice has been to attach a shedule listing all of the 1099's I received, which so far has always been less than my gross income. Sometimes I have failed to list all of the 1099s, which has resulted in a letter from the IRS. The IRS accepted my explanation that I reported the income, but failed the list the 1099 itself, and that was that.

If you need to adjust the amount shown on the 1099, then just list the gross amount and separately adjust it.

I know that the rules for settlement funds have changed, but since I don't handle settlements, I haven't paid attention. Perhaps you now have to issue a 1099 of your own to your client, and I understand some lawyers object to that and don't do it.

Paul Hogan, California

Bob Wood has a great article on this issue: http://www.woodllp.com/Publications/Articles/pdf/IRS_Form_1099_Ten.pdf

Kelly Phillips Erb

Thanks to everyone who took the time to respond. Much appreciated.
