

MEMORANDUM

TO: Ohio Association for Court Administration

FROM: Howard L. Richshafer, Esq.

DATE: January 27, 2012

RE: A Court's Obligation to File Annual Forms 1099-MISC with Internal Revenue Service for Certain Payments to Attorneys

Question Presented

An Ohio court (a "Court") may collect garnishments and levies on behalf of plaintiffs' attorneys. The Court deposits those collections into its operating fund account. The Court then issues its own checks payable to those attorneys and mails the checks to the attorneys' business addresses. Must a Court report these payments to Internal Revenue Service ("IRS") albeit the attorneys are not employed by the Court as employees or independent contractors?

Short Answer: Yes. More likely than not, a Court is required to prepare and file annual Forms 1099-MISC with IRS if aggregate annual payments to an attorney equals or exceeds \$600. The Court should report such payments to each attorney in Box 14, Form 1099-MISC, "Gross Proceeds Paid to an Attorney." Forms 1099-MISC must be attached to Form 1096 "Annual Summary and Transmittal of U.S. Information Returns," and filed with IRS on or before February 28 of the succeeding year. For tax year 2011 payments, the forms should be mailed to "Department of the Treasury, IRS Center, Austin, Texas, 73301." A Court is also required to solicit the attorney's federal taxpayer identification number to prepare accurate Forms 1099-MISC. A Court must also provide a copy of Form 1099-MISC to the attorney.

Federal Filing Obligation.

In the 1990's, IRS undertook a special project to identify attorneys who failed to file federal income tax returns. This project was known as "Project Esquire." Project Esquire implicitly acknowledged that attorneys needed particular tax scrutiny. Although most were given an opportunity to pay their taxes, some were criminally prosecuted. Moreover, IRS has also long had an interest in the taxability of litigation settlements, as well as judgments and attorney fees.

In 1997, Congress reacted to the Project Esquire program by enacting §6045(f) of the Internal Revenue Code ("Code"), which requires Form 1099 reporting of noncompensatory payments to attorneys. That section requires Form 1099 reporting even though no legal services were actually performed for the payor.

More specifically, §6045(f) provides that any person engaged in a trade or business making a payment to an attorney shall file an information return with IRS.¹ That "person" shall also provide a statement to the attorney denoting the information return filed with IRS.² The

¹ 26 USC 6045(f)(1).

² Id.

appropriate information return is IRS Form 1099-MISC. ³ Such payments must be reported in Box 14, Form 1099-MISC, “Gross Proceeds Paid to an Attorney,” if they do not represent wages or compensation paid to an attorney for legal services rendered to the payor.⁴

The word “person” includes any governmental unit and any agency or instrumentality of a governmental unit.⁵ Thus, relevant payments by federal, state, or local government agencies to attorneys are also reportable.⁶ Moreover, nonprofit organizations making such payments are deemed to be engaged in a “trade or business” thus requiring them to report payments to attorneys.⁷

Thus, a payor’s filing obligation applies irrespective of whether or not the attorney performs legal services for the payor.⁸ If a payment represents compensation to an attorney for legal services rendered to the payor, the payor is still obligated to file an information return utilizing either Form W-2 (employee compensation) or Form 1099-MISC (nonemployee compensation).⁹

The word “attorney” means a person engaged in practicing law, whether as a sole proprietorship, partnership, corporation, or joint venture.¹⁰ A payment to a law firm is considered a payment to an attorney, thus triggering the reporting obligation.¹¹ The exemption from reporting payments to corporations does not apply to payments for legal services.¹²

Payments for “legal services” means all services related to, or supporting, the practice of law performed by or under an attorney’s supervision.¹³

“Payor” means a person making a payment to an attorney if that payor-person is an obligor on that payment.¹⁴ An “obligor” is defined as one undertaking an obligation.¹⁵

The term “payment to an attorney” includes a payment by check, cash, wire, or electronic transfer.¹⁶ It includes a check on which: (a) an attorney is named as sole, joint, or alternative payee, or, (b) it is payable to an attorney’s client trust fund.¹⁷ Nonetheless, an attorney is not considered a payee if the attorney’s name is included on the payee line as “in care of,” such as a check payable to “client c/o attorney,” or if an attorney’s name is included on the check in any other manner that does not allow the attorney to negotiate it.¹⁸

³ See Instructions for IRS Form 1099-MISC, (2011), page 2.

⁴ Id.

⁵ 26 USC 6045(c)(4).

⁶ See Instructions for IRS Form 1099-MISC, (2011), page 1.

⁷ Id.

⁸ 26 USC 6045(f)(2)(A).

⁹ 26 USC 6045(f)(2)(B); U.S. Treas. Reg. §1.6045-5(a)(1)(ii).

¹⁰ U.S. Treas. Reg. §1.6045-5(d)(1).

¹¹ See Congressional Committee Report, Conference Report 105-220, “Reporting of Certain Payments Made to Attorneys,” Taxpayer Relief Act of 1997, P.L. 105-34, (8/5/1997).

¹² See Instructions for IRS Form 1099-MISC, (2011), page 2. Also see Taxpayer Relief Act of 1997, §1021(b), amending 26 USC 6045(f).

¹³ U.S. Treas. Reg. §1.6045-5(d)(2).

¹⁴ U.S. Treas. Reg. §1.6045-5(d)(3).

¹⁵ Black’s Law Dictionary, Eighth Edition.

¹⁶ U.S. Treas. Reg. §1.6045-5(d)(4).

¹⁷ Id.

¹⁸ Id.

The Treasury regulations provide numerous examples of these reporting rules with the following being representative:

Example One. Defendant Settles Lawsuit Making Settlement Payment Jointly to Plaintiff and Plaintiff's Attorney.

Plaintiff filed a lawsuit against defendant. The lawsuit settled for \$300,000. Defendant issued a \$300,000 settlement check payable jointly to plaintiff and plaintiff's attorney. Plaintiff's attorney retained \$120,000 as a legal fee and disbursed \$180,000 to plaintiff. Under the 1099-MISC reporting rules, defendant (as payor) must file Form 1099-MISC reporting \$300,000 as gross proceeds paid to plaintiff's attorney.¹⁹

That Example clearly illustrates the breadth of the payor's filing obligation albeit (a) the attorney did not render any legal services to the payor, (b) the reported payment did not accurately identify the actual legal fee earned by plaintiff's attorney, and (c) the payor had no knowledge of whether the reportable payment reflected the plaintiff's attorney's actual fee. The payment simply represented the transfer of gross proceeds to an attorney thus triggering the payor's 1099 reporting obligation under the law. And this applies even though the \$300,000 check was payable jointly to the plaintiff and plaintiff's attorney.

Example Two. Check Delivered to Nonattorney Payee.

Payor listed the attorney and a nonattorney (e.g., the attorney's client) as payees on the check. The payor delivered the check to the nonattorney payee. Under the 1099-MISC reporting rules, the payor must file Form 1099-MISC with respect to the payee attorney.²⁰ If multiple attorneys and a nonattorney were listed as payees and payor delivered the check to the nonattorney payee, the payor must file Form 1099-MISC with respect to the first attorney payee listed on the check.²¹

Example Three. Check Delivered to Nonattorney Nonpayee.

Two or more attorneys were the only payees listed on the check. Payor delivered the check to a nonattorney. Under the 1099-MISC reporting rules, the payor must file Form 1099-MISC with respect to the first-listed payee attorney.²²

Example Four. Check Delivered to One Payee Attorney.

Payor listed Attorney A and Attorney B as payees on the check. Payor delivered the check to Attorney B. Under the 1099-MISC reporting rules, the payor must file Form 1099-MISC with respect to Attorney B because payor delivered the check to Attorney B.²³

Under the current reporting rules, a person has multiple reporting obligations to disclose noncompensatory payments to an attorney that equals or exceeds \$600 per year in the aggregate; the payor is obligated under the law to:

¹⁹ U.S. Treas. Reg. §1.6045-5(f), Example (2).

²⁰ U.S. Treas. Reg. §1.6045-5(b)(1)(ii).

²¹ *Id.*

²² U.S. Treas. Reg. §1.6045-5(b)(1)(iii).

²³ U.S. Treas. Reg. §1.6045-5(b)(1)(i).

- (1) Solicit the attorney's taxpayer identification number ("TIN") to accurately report payments to that attorney on a required Form 1099-MISC.²⁴ The solicitation should occur at or before the time the payor pays the attorney.²⁵ The attorney is required to furnish the correct TIN to the payor, but is not required to certify the TIN.²⁶ The payor may use Form W-9 to solicit an attorney's TIN from the attorney, but is not required to use Form W-9.²⁷ An attorney is required to promptly supply the TIN to the payor and failure to do so may subject the attorney to a civil penalty.²⁸ Also, if an attorney fails to supply the TIN to the payor, the payment is subject to backup withholding under the law.²⁹ Although this Memorandum does not discuss the detailed federal backup withholding rules, they generally require the payor to withhold 28% of the payment and remit the withheld amount to IRS;³⁰ and,
- (2) File Forms 1099-MISC with IRS on or before February 28 of the year following payment; Forms 1099-MISC should be transmitted to IRS using Form 1096³¹; any noncompensatory payments made to attorneys under these rules should be reported in Box 14, Form 1099-MISC, "Gross Proceeds Paid to Attorneys"³²; Forms 1096/1099-MISC must be filed electronically with IRS if 250 or more 1099-MISCs are required to be filed³³; and,
- (3) Furnish a written statement to the attorney containing the information required to be shown on the form.³⁴ Generally, a payor fulfills this obligation by providing a copy of Form 1099-MISC to the attorney.³⁵ The written statement or a copy of the Form 1099-MISC must be provided by the payor to the attorney by February 15 of the year following the calendar year in which payment was made.³⁶

Penalties for Failing to Comply with the Form 1099 Reporting Rules.

The Code contains numerous civil penalties for failing to file appropriate information returns with the IRS. Form 1099-MISC is such an information return. Penalties assessed against a payor range anywhere from \$50 to \$250 per return dependent on whether a failure rises to the level of intentional disregard.³⁷ Special statutory rules also apply to reduce or mitigate penalties for noncompliance.³⁸

IRS studies have revealed widespread noncompliance by governmental entities that are required to file information returns.³⁹ In fact, IRS has specific examination techniques,

²⁴ U.S. Treas. Reg. §1.6045-5(e).

²⁵ Id.

²⁶ Id.

²⁷ See Instructions for IRS Form 1099-MISC, (2011), page 2.

²⁸ Id. The civil penalty is contained under 26 USC 6723.

²⁹ U.S. Treas. Reg. §1.6045-5(e); also see Instructions for IRS Form 1099-MISC, (2011), page 2.

³⁰ 26 USC 3406; U.S. Treas. Reg. §1.6045-5(e).

³¹ See 2011 Form 1096 Instructions.

³² See Instructions for IRS Form 1099-MISC, (2011), page 2.

³³ See 2011 Form 1096 Instructions, page 1.

³⁴ 26 USC 6045(f)(1); U.S. Treas. Reg. §1.6045-5(a)(3)(i).

³⁵ U.S. Treas. Reg. §1.6045-5(a)(3)(i).

³⁶ Id.

³⁷ 26 USC 6721, 26 USC 6722, and 26 USC 6723.

³⁸ Id.

³⁹ See Internal Revenue Manual, Part 4, Examining Process, Chapter 90, Federal, State and Local Governments, IRM 4.90.4.3.2 (2/1/2008).

compliance checks, and penalty procedures in place relating to information return noncompliance by governmental entities.⁴⁰ Based on those studies, it is likely IRS will concentrate examination resources to detect noncompliant governmental entities that are required to file Forms 1099-MISC for payments to attorneys.

Conclusions.

It is more likely than not that a Court is required to file Forms 1099-MISC for noncompensatory payments to attorneys equaling or exceeding \$600 per year in the aggregate for the following reasons:

- 1) A Court is in the judicial branch of government; thus, it is a “person” under these 1099 reporting law rules;
- 2) In the course of its official business, a Court has made payments to attorneys, irrespective of whether there was an employee-employer or independent contractor relationship between it and the attorneys;
- 3) The payments represented proceeds from garnishments or levies, which a Court would be obligated to tender to attorneys representing plaintiff litigants; thus, the Court is clearly an obligor to the attorneys and their clients;
- 4) The Court designated an attorney as sole payee on the checks and mailed them to the attorney’s business address; and,
- 5) There is nothing in the Code, associated Treasury regulations, or IRS instructions exempting a Court or excluding these payments from the Form 1099 reporting procedures.
- 6) Thus, the *prima facie* elements of the Code and associated regulations would be literally met thus requiring a Court to report such payments to IRS.

As discussed on page four, *supra*, the Court should solicit an attorney’s federal taxpayer identification number (“TIN”) once aggregate payments equal or exceed \$600 per year. This can be accomplished by mailing Form W-9 to the attorney before payment is made. The attorney is required to promptly provide the TIN to the Court. If an attorney fails to provide the required TIN to the Court, the Court is required to withhold 28% of the payment and remit the withheld amount to IRS. The balance of the payment would then be made to the attorney, but the 1099 must reflect the gross amount and the 28% withheld tax separately.⁴¹

For tax year 2011, where the Court has not solicited an attorney’s TIN, the following sample draft letter to an attorney can be considered by the Court:

⁴⁰ *Id.*

⁴¹ U.S. Treas. Reg. §1.6045-5(f), Example (6).

Sample Draft Letter to Solicit Attorney's TIN⁴²

Dear Attorney:

During tax year _____, the Court made noncompensatory payments to you equaling or exceeding \$600 in the aggregate. These payments represented gross proceeds of garnishments or levies for one or more of your clients.

The Internal Revenue Code, associated Treasury regulations, and relevant IRS instructions require the Court to solicit your federal taxpayer identification number ("TIN") and to report these payments timely to the IRS. These authorities also require an attorney to promptly furnish the attorney's TIN to the payor, irrespective of whether the attorney is a sole proprietorship, partnership, corporation, or other entity. If an attorney fails to furnish a correct TIN to the payor, the attorney may be subject to a civil penalty under the Internal Revenue Code, and the payor will be required to commence backup withholding of 28% on reportable payments.

The Court is required to report these payments to the IRS using IRS Form 1099-MISC by February 28 of the year following the year of payment. The Court is also required to provide a copy of the Form 1099-MISC to you on or before February 15 of the year following the year of payment.

Please furnish your correct TIN to the Court no later than _____ so the Court can comply timely with these reporting obligations. We enclose IRS Form W-9, which you can use to certify your correct TIN. Please return Form W-9 to this office as soon as possible.

Your cooperation is greatly appreciated.

⁴² This letter assumes a Court made payments aggregating \$600 or more without first soliciting the attorney's TIN. Thus, it should only be used for tax year 2011 or earlier tax years. The relevant Treasury regulations allow a payor to solicit the attorney's TIN using either Form W-9, or, otherwise. Form W-9 can be used to require an attorney to certify the attorney's TIN to the payor. Nonetheless, it is recommended that the Court enclose Form W-9 with the draft letter requiring an attorney to certify the correct TIN.