About

Resources

TOC ›

IRS Reporting Requirements for Attorney Fees, Back Pay, or Wages

The purpose of this notice is to ensure that employees are aware of the Internal Revenue Service (IRS) income reporting requirements when attorney fees are awarded.

In 2005, the IRS issued regulations that changed how attorney fee awards are to be treated for tax reporting purposes, based upon the Supreme Court's decision in Commissioner v. Banks, 125 S. Ct. 826 (2005). Previously, when payment of attorney fees was made directly to the attorney, the payment to the attorney was only reported on the attorney's Form 1099-MISC, *Miscellaneous Income.* In Commissioner v. Banks, the Supreme Court held that when a litigant's recovery constitutes income, the litigant's income includes the portion of the recovery paid to the attorney as a contingent fee. Thus, pursuant to Internal Revenue Code (IRC) section 6041(a) and 6045(f), these fees cannot be excluded from the plaintiff's gross income for tax reporting purposes.

The following situations require variations in the reporting requirements:

■ *Attorney Fees Paid Directly to an Attorney* — These fees will be reported in Box 3 (Other Income) on the employee's Form 1099-MISC. These fees will also be reported on the attorney's Form 1099-MISC.

■ *Settlement (no back pay or wages) is Paid Directly to Employee and Attorney Fees are Identified* — The entire amount of the settlement (including attorney fees) will be reported in Box 3 (Other Income) on the employee's Form 1099-MISC. The employee's attorney will not be issued a Form 1099-MISC.

■ *Settlement (back pay or wages) is Paid Directly to Employee and Attorney Fees are Identified* — The back pay or wages portion of the settlement is subject to income and Federal Insurance Contributions Act (FICA) tax withholdings. The back pay or wages portion will be reported on the employee's Form W-2. The identified attorney fees will be reported in Box 3 (Other Income) on the employee's Form 1099-MISC. The employee's attorney will not be issued a Form 1099-MISC.

■ *Settlement (back pay or wages) is Paid Directly to Employee and Attorney Fees are not Identified* — The entire amount of the settlement (including attorney fees) is subject to income and FICA tax withholdings. The entire amount will be reported on the employee's Form W-2. The employee's attorney will not be issued a Form 1099-MISC.

■ *Settlement Check (no back pay or wages) is Issued Jointly to Employee and Attorney* — The entire amount of the settlement will be reported in Box 3 (Other Income) on the employee's Form 1099-MISC and will also be reported on the attorney's Form 1099-MISC.

■ *Settlement Check (back pay or wages) is Issued Jointly to Employee and Attorney* — The entire amount of the settlement (including attorney fees) is subject to income and FICA tax withholdings. The entire amount will be reported on the employee's Form W-2. The net amount of the settlement (the actual amount of the check) will be reported on the attorney's Form 1099-MISC.

■ *Settlement Check (back pay or wages) is Split between Employee and Attorney* — The entire amount of the settlement (including attorney fees) is subject to income and FICA tax withholdings. The settlement check is issued to the employee, but before disbursement the check is pulled and the net of the settlement (the actual amount of the check) is split between the employee and his or her attorney. The entire amount of the settlement will be reported on the employee's Form W-2. The actual amount of the check paid to the attorney will be reported on the attorney's Form 1099-MISC.

The United States Postal Service® makes no representation regarding the taxability of these payments. Potential tax liability resulting from any of these payments is the employee's responsibility. The IRS makes the determination on whether taxes must be paid. The Postal Service™ does not provide tax advice. Employees should direct any tax reporting questions to the IRS or a qualified tax attorney or accountant.

— Payroll,
Controller, 3-7-24

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