

You Can't Trust Your 1099s

Why you need your own system to track outside payments.

BY STEVEN J. CAGNETTA, ESQ, AND STEVEN K. LADD

This time every year, thousands of physicians who engage with industry outside their employment receive 1099-MISC forms from the organizations that engaged them. Most just forward these documents to their CPAs. For many, that could be a very expensive mistake.

WHAT IS A FORM 1099-MISC?

A 1099-MISC is a type of information return. Essentially, it is a tax document that businesses are required to file to report certain business transactions to the Internal Revenue Service (IRS). Employee physicians receive a Form W-2; consultants receive a Form 1099-MISC.

The Example Form 1099-MISC shows that Medco paid Dr. John Smith \$5,023.17 in Box 7 as "nonemployee compensation." If Dr. Smith looks at this document before tossing it with his other tax papers, he might think, "That's an odd amount. I don't remember getting paid that."

WHAT IS REPORTED ON A 1099?

Surprisingly, companies report compensation to physicians and the IRS differently. Some report actual consulting payments along with expense reimbursements. In the example shown, \$3,000 may have been compensation for 1 day of consulting and 1 day of travel, and \$2,023.17 may have been reimbursement for airfare, hotel, rental car, meals, and home airport parking.

Some companies report actual compensation and do not report reimbursed expenses. That would change the value in the example Box 7 to \$3,000.

There's even another option. Some companies utilize the services of outside expense management vendors. Continuing our example, Medco would pay Dr. Smith \$3,000 during the year and would issue a 1099-MISC

EXAMPLE FORM 1099-MISC			
<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0115	
PAYER'S name, street address, city or town, province or state, country, ZIP or foreign postal code, and telephone no. Medco 1 Main Street Cambridge, MA 02138		2013 Form 1099-MISC	Miscellaneous Income
PAYER'S federal identification number 98-7654321	RECIPIENT'S identification number 123-45-6734	1 Rents \$ 2 Royalties \$ 3 Other income \$	4 Federal income tax withheld \$ 5 Fishing boat proceeds \$
RECIPIENT'S name John Q. Smith Street address (including apt. no.) c/o Primacea, Inc. 11 Chestnut Street, Suite 7 City or town, province or state, country, and ZIP or foreign postal code Andover, MA 01810		6 Medical and health care payments \$ 7 Nonemployee compensation \$ 5,023.17 8 Substitute payments in lieu of dividends or interest \$ 9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/> 10 Crop insurance proceeds \$ 11 Foreign tax paid \$ 12 Foreign country or U.S. possession \$	Copy B For Recipient This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Account number (see instructions) \$		13 Excess golden parachute payments \$ 14 Gross proceeds paid to an attorney \$ 15a Section 409A deferrals \$ 15b Section 409A income \$	16 State tax withheld \$ 17 State/Payer's state no. \$ 18 State income \$
Form 1099-MISC (keep for your records)		www.irs.gov/form1099misc Department of the Treasury - Internal Revenue Service	

with that amount in Box 7. Medco's vendor, Travelco, would reimburse Dr. Smith \$2,023.17 during the year and would issue a separate 1099-MISC with that amount in Box 7.

WHY DOES REPORTING OF EXPENSE REIMBURSEMENTS MATTER?

Physicians who consult for many companies, attend events, and speak at conferences can incur thousands of dollars of expenses per month. When reimbursed by the client or conference organizer, it's easy for them to think that the expense "is taken care of." But reimbursement payments are not classified as income and therefore are not taxable. If physicians are not attentive to these expenses being reported to the IRS on a 1099-MISC, these amounts will be added to their Schedule C income and are subject to federal income tax, state income tax, and self-employment tax. These taxes could total more than half of the reimbursed expenses.

IT IS WRONG TO ASSUME A COMPANY WILL GET IT RIGHT

In our experience, some 1099s overstate actual compensation. This year, Primacea found that one 1099-MISC overstated compensation by nearly \$20,000. How could that happen? One would expect that the accounting software that produces checks would also produce 1099s, and that is almost always the case. Here's what happened: a check for nearly \$20,000 was produced in late December and sent to a manager to review, but it was never sent on to the physician. The discrepancy was found when auditing our physician's payment records by comparing them with the 1099s that were received. Our hypothesis that the 1099 was incorrect was supported by an overdue accounts receivable balance of just over \$20,000.

A call to the company confirmed the error. To make matters worse, it wasn't an isolated incident. They told us that the same type of error happened to three other physicians in 2013. The combination of our audit and a phone call resulted in our physician receiving a corrected 1099. We can only hope that the documents for the other physicians were also corrected in time.

Confirming compensation amounts on 1099s is essential to not overpaying taxes.

SOME PAYMENTS ARE REPORTED IN THE "WRONG" YEAR

Companies often clean up their books and pay overdue invoices at year-end. Checks sent by the company in the last week of December are often not received or recorded by busy physicians until well into January. Because the checks were produced in 2013, the company's accounting software will include the payments on 2013 tax reports. However, physicians are likely only to report income in the year in which it was received.

How should these payments that straddle a year boundary be reported? Generally, CPAs tell Primacea that they want to know both what the company reported and when the payment was actually received. Some will report the payments "early" so as to not raise a red flag with the IRS. Others report the payments when received and add notes to the prior year's return.

WHAT IF A COMPANY IS LATE OR DOESN'T SEND A 1099?

Companies are supposed to send 1099s by January 31st of each year. Some miss the deadline (not unlike brokerage firms, private equity firms, and others), and a small percentage never send 1099s. In Primacea's experience, this is more likely to happen when small firms are

acquired by larger businesses and their accounting systems are not fully integrated.

In addition, there is a legitimate reason for an organization not to send a 1099. When payments total less than \$600 per year, no 1099 is required.

Even if payments aren't reported on a 1099, physicians as taxpayers are required to include them on their tax returns. If they are "forgotten" by physicians in the past, the main risk arose in an IRS audit that reviewed bank deposits. Going forward, the IRS will be able to review Open Payments reports, too. If payments are omitted, whether by error or on purpose, physicians will be responsible for paying the tax plus interest and penalties. Further, they may also be subject to criminal prosecution; tax returns are signed under penalty of perjury, and underreporting is a crime.

WHAT SHOULD PHYSICIANS DO?

Payments related to compensation and expense reimbursements need to be tracked for both tax and Sunshine (Open Payments) purposes. There are many accounting systems that are capable of recording physician payments such as QuickBooks, Freshbooks, Xero, and Wave, but few physicians have the time or desire to be part-time bookkeepers.

CPAs, bookkeepers, and organizations such as Primacea are set up to provide complete back-office support for busy physicians. What's important for physicians who are "solo consultants" is to keep good records. Payments can be tracked with a spreadsheet or a file containing check stubs.

Segregating consulting income and expenses from personal ones can be particularly helpful for physicians and their bookkeeping/tax professionals. Two accounts should be sufficient: a designated bank account to receive consulting income and a separate credit card for all consulting expenses. Other income and personal expenses should not be run through these accounts. At tax time, the bank and credit card records will allow tax professionals to more accurately determine income and deductions. ■

Primacea provides tools to physicians and leading hospitals to facilitate transparency in innovation and manage compliance obligations. For more information, please visit www.primacea.com.

Steven J. Cagnetta, Esq., is Founder and Chief Counsel at Primacea, Inc. in Andover, Massachusetts. He may be reached at (781) 369-2900; steve.cagnetta@primacea.com.

Steven K. Ladd is Founder and President at Primacea, Inc. in Andover, Massachusetts. He may be reached at (617) 901-3140; steven.ladd@primacea.com.