American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

April 1, 2013

Mr. Steven T. Miller
Acting Commissioner
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, DC 20224

Re: Notice 2012-65 – Information Reporting for Discharges of Indebtedness

Dear Messrs. Miller and Wilkins:

The American Institute of Certified Public Accountants (AICPA) is pleased to provide comments on Notice 2012-65, Information Reporting for Discharge of Indebtedness. These comments were developed by the AICPA Individual Income Taxation Technical Resource Panel and approved by the AICPA Tax Executive Committee.

The AICPA is the world's largest membership association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125-year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We support the Internal Revenue Service's (IRS's) efforts to address issues surrounding Form 1099-C, Cancellation of Debt. We strongly believe changes are needed to the filing requirements for Form 1099-C. Specifically, we suggest that IRS require lenders to issue Form 1099-C only upon the legal discharge of a debt, which will occur at the earlier of the expiration of the applicable statute of limitations or when all collection efforts by the lender or surrogate collection organizations have ceased.

Section 6050P and Treasury Regulations

Under section 6050P,[1] certain lenders are required to issue an information return to a debtor by January 31 of the following year if there has been a discharge of indebtedness of $600 or more.

[1]All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated there under, unless otherwise specified.

The information return must show the name, address and tax identification number of the debtor, the discharge date and amount, and other information required by IRS.

Treasury Reg. § 1.6050P-1(a)(1) provides that "a discharge of indebtedness is deemed to have occurred, except as provided in paragraph (b)(3) of this section, if and only if there has occurred an identifiable event described in paragraph (b)(2) of this section, whether or not an actual discharge of indebtedness has occurred on or before the date on which the identifiable event has occurred."[2]

Per Treas. Reg. § 1.6050P-1(b)(2), an "identifiable event" is any of the following:

(A) A discharge of indebtedness under Title 11 of the United States Code (bankruptcy);
(B) A cancellation or extinguishment of an indebtedness that renders a debt unenforceable in a receivership, foreclosure, or similar proceeding in a federal or State court, as described in IRC section 368(a)(3)(A)(ii) (other than a discharge described in paragraph (b)(2)(i)(A) of this section);
(C) A cancellation or extinguishment of an indebtedness upon the expiration of the statute of limitations for collection of an indebtedness, subject to the limitations described in paragraph (b)(2)(ii) of this section, or upon the expiration of a statutory period for filing a claim or commencing a deficiency judgment proceeding;
(D) A cancellation or extinguishment of an indebtedness pursuant to an election of foreclosure remedies by a creditor that statutorily extinguishes or bars the creditor's right to pursue collection of the indebtedness;
(E) A cancellation or extinguishment of an indebtedness that renders a debt unenforceable pursuant to a probate or similar proceeding;
(F) A discharge of indebtedness pursuant to an agreement between an applicable entity and a debtor to discharge indebtedness at less than full consideration;
(G) A discharge of indebtedness pursuant to a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge debt; or
(H) In the case of an entity described in section 6050P(c)(2)(A) through (C), the expiration of the non-payment testing period, as described in Treas. Reg. § 1.6050P-1(b)(2)(iv).

[2] As noted in IRS Information Letter 2008-207, "The Internal Revenue Service does not view a Form 1099-C as an admission by the creditor that it has discharged the debt and can no longer pursue collection. Section 1.6050P-1(a) of the regulations provides that, solely for purposes of reporting cancellation of indebtedness, a discharge of indebtedness is deemed to occur when an identifiable event occurs whether or not an actual discharge of indebtedness has occurred on or before the date of the identifiable event."

Treasury Reg. § 1.6050P-1(b)(3) provides that if there is a discharge before the date of an "identifiable event," the lender may, at its discretion, issue an information return. Thus, with the eight events listed above (A - H), there are nine events that require issuance of Form 1099-C.

Under Treas. Reg. § 1.6050P-1(b)(2)(iv), the expiration of the non-payment testing period is defined as follows:

> There is a rebuttable presumption that an identifiable event under paragraph (b)(2)(i)(H) of this section has occurred during a calendar year if a creditor has not received a payment on an indebtedness at any time during a testing period (as defined in this paragraph (b)(2)(iv)) ending at the close of the year. The testing period is a 36-month period increased by the number of calendar months during all or part of which the creditor was precluded from engaging in collection activity by a stay in bankruptcy or similar bar under state or local law. The presumption that an identifiable event has occurred may be rebutted by the creditor if the creditor (or a third-party collection agency on behalf of the creditor) has engaged in significant, bona fide collection activity at any time during the 12-month period ending at the close of the calendar year, or if facts and circumstances existing as of January 31 of the calendar year following expiration of the 36-month period indicate that the indebtedness has not been discharged. For purposes of this paragraph (b)(2)(iv)—
>
> (A) Significant, bona fide collection activity does not include merely nominal or ministerial collection action, such as an automated mailing;
> (B) Facts and circumstances indicating that an indebtedness has not been discharged include the existence of a lien relating to the indebtedness against the debtor (to the extent of the value of the security), or the sale or packaging for sale of the indebtedness by the creditor; and
> (C) In no event will an identifiable event described in paragraph (b)(2)(i)(H) of this section occur prior to December 31, 1997.[3]

In 2008, the section 6050P regulations were modified. One change included limiting the application of the 36-month non-payment testing period to an applicable financial entity as described in section 6050P(c)(2)(A) to (C). The preamble to the regulations which made this change (TD 9430; 11/10/08) noted that the 36-month non-payment identifiable event can "trigger a reporting requirement even when the entity has not legally or practically discharged the debt." The limitation of this event to financial institution lenders was made "in order to avoid premature information reporting of cancellation of indebtedness income." Further, the IRS noted that "doing so will reduce the information reporting burden on entities that were not originally within the scope of the 36-month rule and will protect debtors from receiving information returns that

[3] These events are also required to be noted on Form 1099-C in box 6 using a provided code. *See* http://www.irs.gov/pub/irs-pdf/f1099c.pdf.

prematurely report cancellation of indebtedness income from such entities."

Confusion and Misreporting Due to the 36-Month Non-Payment Testing Period

The Tax Court in *Kleber* noted that "Issuance of a Form 1099-C is an identifiable event, but it is not dispositive of an intent to cancel indebtedness."[4] When a Form 1099-C is issued for a year that does not correspond to the true cancellation of debt, confusion results for the borrower, and there is risk to the government that the income will never be reported.

The confusion for the borrower results from not knowing when to report the income or the amount to report. A borrower may not know if a short period of no collection activity is permanent or temporary. Thus, the borrower is unlikely to guess that the debt has been cancelled and report the income (without receipt of a Form 1099-C). In addition, a borrower may receive a Form 1099-C in a year later than that when the debt was cancelled. In these situations, it is possible that the proper year for reporting is "closed" (under the statute of limitations) when the Form 1099-C is received.

For example, in *Kleber, et ux.,* TC Memo 2011-233, the taxpayer received Form 1099-C in 2006 for debt the court determined was discharged in 2002. In this case, outstanding lease payments were converted to a debt in 1999. The debt was referred to collection in 2002, and the lender ultimately determined it was uncollectible in 2004. The lender wrote off the debt in 2005 and issued Form 1099-C in 2006. Under these circumstances, the court held that the 36-month testing period started in 1999 and thus ended in 2002. The court also found that there was no evidence of "any substantive collection activities" after 1999. Thus, cancellation of debt income that was required to be reported in 2002 was likely not reported at all.

Similarly, in *Stewart*, TC Summary Opinion 2012-46, a credit card company discharged the taxpayer's debt in 1996 but sold the debt to a collection company. The debt was later sold to another company which issued a Form 1099-C in 2008. The court found that the 36-month testing period ended in 1999. Thus, the Form 1099-C was issued several years too late with the result that the cancellation of debt income could not have been properly reported as the year when the debt actually was eligible for being included in income had long past.

Recommendations

The 36-month testing period should be removed from the list of "identifiable events" in Treas. Reg. § 1.6050P-1(b)(2)(i). Further, to ensure that cancellation of debt income is properly reported by lenders and borrowers, the section 6050P regulations should be amended to require a lender to issue a Form 1099-C only for the year that a debt is legally discharged.

[4] *Kleber*, *et ux*. TC Memo 2011-233, referring to *Owens*, TC Memo 2002-253.

We also encourage the IRS to verify with other government agencies involved with credit card and other debts to ensure that there is consistency between the Form 1099-C rules and those for legal discharge of debt. A borrower should not receive a Form 1099-C if the lender or a third party purchaser of the debt intends to continue collection efforts. In the *Stewart* case (noted above), a second company purchased the credit card debt after the statute of limitations had expired.[5] We encourage the IRS to work with relevant federal agencies to prohibit such activities. Such collaboration will help to reduce confusion and error regarding the issuance of Form 1099-C and proper reporting of cancellation of debt income.

We believe that such changes will decrease the burden on both creditors and taxpayers.

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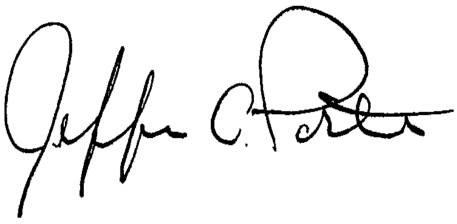
Thank you for considering our views on this very important topic. If you have any questions or would like to discuss this issue or our recommendations, please contact me at (304) 522-2553 or jporter@portercpa.com; Jonathan Horn, Chair of the AICPA Individual Income Tax Technical Resource Panel, at (212) 744-1447 or JMHCPA@verizon.net; or John Scheid, AICPA Technical Manager, at (202) 434-9268 or jscheid@aicpa.org.

Sincerely,



Jeffrey A. Porter, CPA
Chair, AICPA Tax Executive Committee

cc: Janet Engel Kidd, Associate Chief Counsel, Procedure & Administration Internal Revenue Service

[5] Per the court in *Stewart,* "Although aware that a state statute of limitations period for commencing collection activity in regard to the debt had expired on February 15, 2001, a third party began making automated attempts to collect payments from petitioner."