Comments to Internal Revenue Service on Notice 2012-65

by Low Income Tax Clinic Directors, the National Association of Consumer Advocates, and the National Consumer Law Center, on behalf of its low income clients

March 14, 2013

COMMENTERS

These comments are submitted by the National Association of Consumer Advocates,[1] the National Consumer Law Center ("NCLC"),[2] on behalf of its low-income clients, and Low Income Tax Clinic Directors.[3] The individuals with principal drafting responsibility[4] for these comments are:

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[1] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[2] The **National Consumer Law Center®** (NCLC®) is a non-profit Massachusetts corporation specializing in low-income consumer issues, with an emphasis on consumer credit. Since 1969, NCLC has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness. NCLC publishes a series of consumer law treatises including *Fair Debt Collection*, *Consumer Bankruptcy and Practice,* and *Foreclosures.*

[3] Congress established and funded the low income tax clinic program in the IRS to provide free or low cost legal representation to low-income individuals seeking to resolve problems with IRS. *See* IRC § 7526.

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We are joined in these comments by the following attorneys, most of whom direct or are affiliated with Low Income Taxpayer Clinics:

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SUMMARY OF RECOMMENDATIONS

We submit these comments in response to Notice 2012-65 requesting guidance on Treas. Reg. § 1.6050P-1(b)(2)(i)(H). In particular, the Notice requests comments on whether IRS should amend the regulation to remove the provision which pertains to the 36 month non-payment testing period. For the reasons we discuss below, we urge IRS to amend the regulation to remove the non-payment testing period as an identifiable event. In addition, we would welcome the opportunity to comment on other sections of this

regulation, including Treas. Reg. § 1.6050P-1(b)(3), which permits reporting whether or not an identifiable event has occurred, and Treas. Reg. § 1.6050P-1(e), which pertains to multiple debtors and creditors.

Our specific recommendations are:

1. Eliminate the 36 month testing period contained in Treas. Reg. § 1.6050P-1(b)(2)(i)(H).
2. Allow issuance of the 1099-C only when the debt is extinguished, whether extinguished by the original creditor or by a debt purchaser. Only one 1099-C should be issued per debt, and it should be issued only after extinguishment of the debt. No other circumstances, including sale of the debt, transfer of collection authority, a hiatus in collection activity, or a period of non-payment, should trigger issuance of a 1099-C.
3. In the event IRS decides to retain the current rule, we urge IRS to include clear and conspicuous language on the face of the 1099-C that a taxable event may not have occurred, that a creditor may not have extinguished the debt, and that creditor collection activity may be ongoing.

BACKGROUND

IRC § 61 codifies the longstanding definition of income as "all income from whatever source derived..." This notion of income as an accession to wealth, Commissioner v. Glenshaw Glass, 348 US 426 (1955), includes tangible income such as wages from employment, less tangible assignment of income, Old Colony Trust Co. v. Commissioner, 279 US 716(1929), and, the least tangible example, cancellation of debt

income, IRC § 61(a)(12). Rood v. Comm'r, T.C. Memo 1996-248, aff'd 122 F.3d 1078 (11th Cir. 1997).

Cancellation of debt income is reported to IRS and to debtors by creditors engaged in the business of lending money, IRC §6050P(c), and is reported on Form 1099-C where that cancelled debt is $600 or more.[5] The reported income includes cancelled debt from such concrete identifiable events as bankruptcy, Treas. Reg. 1.6050P-1(b)(2)(i)(A), a court decision upholding a debtor's statute of limitations defense, Treas. Reg. 1.6050P-1(b)(2)(i)(C), and an agreement to otherwise terminate the underlying obligation, id. at (F). It also includes the less concrete expiration of a "non-payment testing period." Id. at (H). Taxpayers report the income from discharged debt on Form 982, attached to the long form 1040.

This 1099-C reporting requirement at the end of a 36 month period of non-payment came into existence after the 1993 enactment of IRC § 6050P. Primarily because the reporting requirement arises without regard to the actual discharge of the debt, it has engendered substantial confusion for taxpayers and IRS.[6] The National Taxpayer Advocate detailed the cancellation of debt exclusion confusion in her 2008 Annual Report to Congress, at Legislative Recommendation No. 6. We discuss these issues as they pertain to the 36 month testing period in these comments at pages 8-10.

Designed ostensibly to answer the concern that taxpayers and creditors were not reporting discharged debt, IRC § 6050P's purpose was "to encourage taxpayer compliance with respect to discharged indebtedness" and "to enhance the ability of IRS

[5]Treas. Reg. 1.6050P-1(a)(4).
[6] *E.g.*, Kleber v. Comm'r, T.C. Memo 2011-233; Stewart v. Comm'r, T.C. Summ. Op. 2012-46; Gaffney v. Comm'r, T.C. Summ. Op. 2010-128,

to enforce the discharge of indebtedness rules."[7] IRS proposed temporary regulations to implement the statute, *see* IRC § 6050P(a), at 58 Fed. Reg. 68301-01(1993). Significantly, the proposed regulations did not include any mention of the 36 month testing period now found at Treas. Reg. 1.6050P-1(b)2)(i)(H). IRS's list of debt cancelling events was short and included three non-exclusive factors: discharge of indebtedness pursuant to a bankruptcy, an agreement between the parties, and a cancellation or extinguishment by law. It also included a "facts and circumstances" test. Id.

More than 200 commenters weighed in on the proposed rules, particularly with regard to the "all the facts and circumstances" test for determining whether a discharge of indebtedness had occurred. The commenters, mostly banks and credit unions, objected to the facts and circumstances test in part because they did not have the resources to ascertain whether a debt would ever have to be paid by the debtor. They also objected to determining and tracking the statute of limitations for collection of each underlying transaction because of the many circumstances that surround each debt.

IRS issued a final regulation in 1996 containing eight identifiable events that require a creditor to issue the 1099-C.[8] The first seven relate to circumstances where the debt has been extinguished. Those events are a bankruptcy discharge, Treas. Reg. 1.6050P-1(b)(2)(i)(A), unenforceability of a debt as the result of certain court proceedings, id. at (B), expiration of the statute of limitations, id. at (C), non-recourse foreclosure, id. at (D), unenforceability of the underlying debt due to a probate action, id.

[7] H. R. Rep. No. 103-11, at 758 (1993)(reprinted in 1993 U.S.C.A.N.N. 378, 989), *quoted in* Nat'l Taxpayer Advocate, 2010 Annual Report to Congress, 384 n. 9.
[8] 61 Fed. Reg. 262 (1996); Treas. Dec. Int. Rev. 8654.

at (E), an agreement of the parties to discharge the debt, id. at (F), and discharge of indebtedness pursuant to the creditor's policy or decision, id. at (G).

IRS added the event now found at Treas. Reg. 1.6050P-1(b)(2)(i)(H), expiration of the 36 month non-payment testing period, without first soliciting public comment. That has not stopped the public from commenting. At least three entities have voiced their concern about the 36 month testing period.

The Association of Credit and Collection Professionals ("ACA") complained about the unworkability of the testing period in its letter of May 2, 2008 to IRS. Its concern was the absence of definition of "significant bona fide collection activities," which would determine whether it is permissible to issue the 1099-C pursuant to Treas. Reg. § 1.6050P-1(b)(2)(i)(H).

The American Bar Association Section on Taxation requested guidance in its July 25, 2011, letter to IRS with regard to the issuance of 1099-Cs where the underlying debt had not been forgiven by the creditor.

Finally, the National Taxpayer Advocate devoted two chapters in her 2010 Annual Report to Congress to this issue. Most Serious Problem Number 10 discussed the misuse of 1099-Cs in private debt collection, the inaccuracies of 1099-Cs, and the issuance of 1099-Cs where private collection activity continues.[9] In that same report, at Legislative Recommendation Number 4, the National Taxpayer Advocate recommended removing the 36 month testing period due to the confusion it creates for taxpayers in a creditor-debtor relationship.[10]

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[9] *See* Nat'l Taxpayer Advocate , 2010 Annual Report to Congress, Vol. I at 149-159.
[10] *See id.* at 383-386.

For the reasons we discuss in these comments, we ask that Treas. Reg. § 1.6050P-1(b)(2)(i) be amended to remove the non-payment testing period as an identifiable event.

ELIMINATION OF THE 36 MONTH TESTING PERIOD PROMOTES THE INTERESTS OF IRS, TAXPAYERS, AND CREDITORS

A fair, comprehensible, and efficient system of taxation promotes the interests of all parties including IRS, taxpayers, and creditors. In her 2012 Annual Report to Congress, Taxpayer Advocate Nina Olson identified the complexity of the Internal Revenue Code as the most serious problem facing taxpayers and IRS.[11] Indeed, this has been a familiar refrain in her Annual Reports to Congress.[12]

The elimination of the 36 month testing period contained in Treas. Reg. §1.6050P(b)(2)(i)(H) is a step toward making the tax system operate in a more fair and efficient manner. Fairness and efficiency are served when:

a. No taxpayer will have a tax consequence arising from discharge of indebtedness except in cases when an actual discharge of indebtedness or extinguishment of the debt has occurred.

b. Information returns are not ambiguous. The issuance of a 1099-C should not be a source of confusion for taxpayers and IRS as to whether a discharge of indebtedness has occurred. Ambiguity requires both taxpayers and IRS to expend limited resources in determining whether a taxable event has actually occurred.

c. Creditors will not have to expend resources to monitor debtor payments and collection efforts solely for the purpose of complying with IRS reporting requirements in situations where there has not otherwise been an actual discharge of indebtedness or extinguishment of the debt.

d. Creditors will not be able to use the issuance or threatened issuance of a 1099-C as a collection tool to compel debtor payments.

e. Tax rules will not be arbitrary.

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[11] Nat'l Taxpayer Advocate , 2010 Annual Report to Congress, Summary of Legal Recommendations #4.
[12] *See e.g.* Annual Reports to Congress for the calendar years 2010, 2008, 2007, and 2004.

NO TAXPAYER SHOULD HAVE A TAX CONSEQUENCE ARISING FROM DISCHARGE OF INDEBTEDNESS EXCEPT IN CASES WHEN AN ACTUAL DISCHARGE OF IDEBTEDNESS OR EXTINGUISHMENT OF THE DEBT HAS OCCURRED

As previously noted, IRC § 61(a)(12) provides that gross income includes income from discharge of indebtedness. There is no legislative history indicating that Congress intended to include within the scope of IRC § 61(a)(12) debts that have not been discharged or extinguished. IRC § 6050P only requires that an applicable entity "which discharges (in whole or in part) the indebtedness of any person" to make an information return. Treas. Reg. §1.6050P(b)(2)(iv) makes the presumption that an identifiable event has occurred upon the expiration of the non-payment testing period rebuttable, at least by the creditor. However, there is no specific mention in Treas. Reg. § 1.6050P of the right of the taxpayer to rebut the presumption when a creditor continues to collect the debt after issuance of the 1099-C. Consequently, inclusion in the regulation of the 36 month testing period as an identifiable event means that some debts that have not been discharged but are still alive will be included in income.

Even if taxpayers have the right to rebut the presumption arising after expiration of the non-payment testing period, many taxpayers do not have the knowledge or resources to do so. When a creditor files a 1099-C with IRS and issues one to the taxpayer, it suggests to IRS that an income producing event has occurred. Many taxpayers assume that the 1099-C represents the end of their debt. They are surprised to discover after receiving a 1099-C that they are still subject to collection efforts by the creditor or its successor. Taxpayers may thus have two creditors, the one who issued the loan and IRS. We discuss this in greater detail starting at page 17.

Taxpayers who fail to properly address the 1099-C in that year's tax return will likely receive a CP2000 from IRS which may lead to an assessment of tax, penalties, and interest. A number of taxpayers never respond to a CP2000 because they are unaware of whether and how to respond, or because they assume that their efforts will be unsuccessful. Indeed, the National Taxpayer Advocate's 2010 Annual Report to Congress observed that approximately one-half of the taxpayers in her study did not respond to the pre-assessment notice stream where IRS matched cancellation of debt income against the taxpayer in the Automated Underreporter examination.[13]

It is unfair for taxpayers to face a tax liability arising from discharge of indebtedness income when the underlying debt has not been extinguished. The regulation so requiring it is not supported by the Internal Revenue Code. The tax system must be fair to inspire public confidence.

THE ISSUANCE OF A 1099-C CONFUSES BOTH TAXPAYERS AND IRS AS TO WHETHER A DISCHARGE OF INDEBTEDNESS HAS OCCURRED, AND CAUSES IRS TO EXPEND ITS LIMITED RESOURCES UNNECESSARILY.

Form 1099-C bears the title "Cancellation of Debt." A reasonable person receiving this form would believe that the debt in question had, in fact, been cancelled. In those cases where it is issued by a creditor following the expiration of the 36 month testing period, an actual extinguishment of the debt and attendant collection may not have occurred, and the creditor or its successor in interest may resume collection activity in the future. Where a creditor is still collecting the debt, the taxpayer will be confused about what to do upon receipt of the 1099-C information return. Many tax preparers are

[13] *See* Nat'l Taxpayer Advocate, 2010 Annual Report to Congress, Most Serious Problem #10, at 155.

equally uncertain about how a taxpayer should treat a 1099-C while the taxpayer is receiving collection notices from the creditor.

Taxpayer confusion usually requires IRS to expend additional resources. Taxpayers may call IRS seeking information and advice on how to proceed. IRS will send out an Automated Underreporter notice if the taxpayer fails to address the 1099-C in the corresponding year's tax return and must consider the taxpayer's response, if any. In cases where the taxpayer has failed to respond, IRS will assess additional tax and pursue collection. Some cases end up in Tax Court. Other taxpayers may request audit reconsideration, file an amended tax return, or take other steps in an effort to cause IRS to reconsider the tax liability. Some taxpayers may not begin to take these steps until after IRS has begun such painful collection activities as levying on income sources.

As discussed below starting on page 17, issuance of a 1099-C before the debt is extinguished results in uncertainty as to the status of the debt, the legality of the creditor's actions, and subsequent litigation. In fact, ACA International, a trade organization of credit and collection professionals, cited the confusion caused by issuance of Form 1099-C when debtors understood it to mean that a discharge of indebtedness had occurred and, contrary to the title of the form, the creditor retained the right to collect the debt.[14]

Eliminating the 36 month testing period as an identifiable event would eliminate this source of confusion. The remaining seven identifiable events in §6050P(b)(2) generate significantly less confusion as all require issuance of a 1099-C only upon the actual extinguishment of a debt.

[14] *See* ACA Recommendations for 2008-2009 Guidance Priority List - Notice 2008-47, May 2, 2008

LOW INCOME TAXPAYERS ARE PARTICULARY HARMED BY THE 36 MONTH TESTING PERIOD

Low income taxpayers are issued a disproportionate percentage of 1099-Cs.

Low income taxpayers are particularly susceptible to tax problems arising from discharge of indebtedness in general and to the application of the 36 month testing period as an identifiable event in particular. In 2010, the National Taxpayer Advocate shared in her Annual Report to Congress the results of a study done by her office regarding the issuance of 1099-Cs. That study found that nearly half of the 1099-Cs were issued to low income taxpayers.[15]

There are several explanations as to why low income taxpayers are issued such a large proportion of 1099-Cs. Our cases show that low-income families struggle to pay their debts. They must choose between paying the bills that meet basic needs and paying those that are less immediate. They also have fewer resources to rely on during periods of reduced income. As a result, they are more likely to purchase consumer goods on credit and suffer the consequences of repossessions, deficiency lawsuits, and cancelled debt income.

The 2011 American Community Survey[16] found that 97.7 million Americans have incomes under 200% of the Federal Poverty Guidelines ("FPG"). Ten and a half percent of all families subsisted at or below the Federal Poverty level. An astounding quarter of those subsisting at the federal poverty level had no work in the last twelve months. Twenty percent of the more affluent poor, those whose income reached 200% of the FPG,

[15] Low income was defined as an adjusted gross income of less than 250% of the federal poverty guidelines. *See* 2010 Nat'l Taxpayer Advocate Serv., Annual Report to Congress, Volume I, at 154.

[16] The American Community Survey (ACS) is an ongoing survey by the U.S. Census Bureau that provides data every year, giving communities the current information they need to plan investments and services.

experienced food insecurity. This means that they lacked enough food to feed their families. Sixty-five percent of these families reported that they had been hungry, but did not eat, because they could not afford enough food.

The existence of the 36 month testing period as an identifiable event simply compounds the debt problems faced by low income taxpayers. By requiring a creditor to issue a 1099-C even when the debt has not been extinguished, the regulation has the perverse potential to add additional debt—in the form of tax liability—to a debtor who is already unable to pay all of his bills.

Low income taxpayers often do not receive 1099-cs issued by their creditors.

Studies show that financial precariousness causes low income families to move more frequently than the general population.[17] Households with income below 150% of the poverty guidelines were twice as likely to move over a one year time span as those households with incomes in excess of 150%.[18] These taxpayers are less likely to receive the 1099-Cs mailed by creditors to their last known address. The National Taxpayer Advocate's 2012 Annual Report to Congress addressed this mobility issue, and called for a revision to the "last known address rules."[19] In the foreclosure context, the last known address is often the address of the foreclosed property, even though the debtor may have left the premises months or even years prior to the issuance of the 1099-C. The Taxpayer Advocate study found that more than 40% of the issued 1099-Cs showed an address for the debtor that was different than the one reported on the debtor's tax return for that

[17] *See* Should I Stay or Should I Go? Exploring the Effects of Housing Instability and Mobility on Children, (2011) National Housing Conference and Center for Housing Policy, http://www.nhc.org/child_mobility.html
[18] 2011 American Community Survey
[19] *See* 2012 Nat'l Taxpayer Advocate Annual Report to Congress, Legislative Recommendation No. 4.

year.[20] Failure to receive the 1099-C virtually guarantees that the taxpayer will fail to take timely steps to avoid having tax incorrectly assessed.

The LITC commentators frequently assist taxpayers who first learn of the existence of a 1099-C upon receiving an Automated Underreporter notice from IRS or once they are in IRS collections. Sometimes, so much time has passed since the issuance of the 1099-C that it is difficult to identify the event that may have generated the 1099-C. The original creditor may not have issued the 1099-C, may have changed its name, relocated, or shuttered its doors. Frequently, enough time has passed that the taxpayer no longer has records to either challenge the information provided by the creditor or to demonstrate insolvency.

The existence of the 36 month testing period as an identifiable event makes it even more likely that the taxpayer will not be aware in a timely fashion of the issuance of a 1099-C. A taxpayer who has been dealing with a creditor who has actually discharged the taxpayer's debt is more likely to know about the discharge and to be unsurprised by the ensuing tax document than a taxpayer who is issued a 1099-C after the expiration of the 36 month testing period. Unless the taxpayer in the second situation actually receives the 1099-C, that taxpayer will have no reason to know there may be an identifiable event. Unlike the other seven identifiable events, the expiration of the 36 month testing period contained in Treas. Reg. 1.6050P(b)(2)(i)(H) does not require anything to actually happen; it is simply based upon the passage of an arbitrary period of time.

[20] Nat'l Taxpayer Advocate, 2010 Annual Report to Congress, Volume I, at 153.

Low income taxpayers are less likely than other taxpayers to be able to address inaccuracies in 1099-Cs.

In 2010, the National Taxpayer Advocate listed inaccuracies in third-party reporting of cancellation of debt events as her number 10 Most Serious Problem. Creditors frequently incorrectly report the fair market value of property received as zero despite the fact that a significant number of 1099-Cs involve real estate foreclosures and repossessed vehicles, both of which involve the transfer to the creditor of property that is likely to have some value.

These inaccuracies are difficult to correct even when the taxpayer receives the 1099-C and detects the error. When a 1099-C is inaccurate, the taxpayer is advised to contact the issuer and request a correct form. The Taxpayer Advocate study found that 13 percent of the 1099-Cs issued came from creditors that appear to no longer exist. The experience of the LITC directors submitting these comments is that contacting a creditor to correct information contained on a 1099-C almost never results in correction of the error.[21] The taxpayer must then convince IRS of the error in the information return. Particularly in cases involving the 36 month testing period, the taxpayer may not have sufficient information to do so, particularly with regard to the extent of creditor collection activities.[22]

[21] *E.g.*, letter from Chase Bank, (Oct. 27, 2009)(refusing to correct the 1099-C it issued while simultaneously pursuing collection of the consumer debt.)(Attached Ex. 1)

[22] *E.g.*, E-mail from Dawn Hulbert, Attorney (Mar. 4, 2012) (reporting that client received CP2000 for nonreporting of discharge of indebtedness income reported in 2011 based on car repossession that occurred in 2006; client had no knowledge of 1099-C and no information as to how discharge of indebtedness was calculated).

Low income taxpayers are less likely than other taxpayers to be able to obtain tax preparation assistance needed to address discharge of indebtedness income.

The effect of the 36 month testing period rule is compounded by the inability of low income taxpayers to retain a tax professional. Those who do hire tax preparers are generally only able to do so because they expect a refund out of which preparation fees can be paid. Limited free assistance is available to this population. Volunteer Income Tax Assistance ("VITA") and Tax Counseling for the Elderly ("TCE") programs, staffed by trained volunteers, provide free tax preparation, and the Low Income Taxpayer Clinic ("LITC") program provides assistance with tax controversies. Despite these valuable efforts, many low income taxpayers do not live near a VITA or TCE site, do not know that these programs exist, or face language barriers to using VITA.[23]

As the IRS notes in its training materials, cancellation of indebtedness income is a complex subject and requires special training.[24] The time estimate for completion of Form 982, used by taxpayers to disclose discharge of indebtedness income and identify exclusions, totals 10.73 hours, according to the form's instructions. That is in addition to the time required to file the long form 1040. Dealing with discharge of indebtedness income requires professional help and is not part of a routine tax return preparation. Even IRS commissioners concede the complexity of this issue.

Many VITA and TCE sites do not prepare returns that involve 1099-Cs. They are limited to circumstances where the debt cancellation is related to foreclosure, and then only when the discharged debt clearly falls within the statutory Qualified Principal Residence Indebtedness Exception, I.R.C. § 108(a)(1)(E) VITA and TCE sites may also

[23] *See* 2012 Annual Report to Congress, Volume I, 232.
[24] *See* I.R.S. Pub. No. 4555, at 10-22 (2009).

deal with credit card debt, but only if the entire amount of discharged debt is included in income; they are not able to assist taxpayers in evaluating whether the cancelled debt may be excluded from income. Volunteers must obtain specific Cancellation of Debt Certification, which involves extra training and passing an additional examination.[25] There is no guarantee that a specific VITA or TCE location will have a volunteer with a Cancellation of Debt Certification. Only approximately 1.1% of the 3.3 million returns prepared by VITA in 2011 involved a 1099-C.[26] Indeed, the National Taxpayer Advocate called attention to this very failing of the VITA program in her 2007 Annual Report to Congress at MSP #2.

Taxpayers are also hampered by paid preparers' inability to understand the complexity of these returns. The National Taxpayer Advocate has bemoaned the fact that many paid tax preparers used by low income taxpayers are not familiar with all of the exclusions for cancellation of indebtedness income and how those are to be claimed.[27] Low-income taxpayers are left in a no-win situation.[28]

The insolvency exception does not cure all of the harms to low income taxpayers created by the 36 month testing period.

Although intuitively one would expect low-income taxpayers to be able to take advantage of the insolvency exception, this is not always the case. Equity in a home or outright ownership of a relatively small asset like a modest trailer, camper, or vehicle may cause the taxpayer to be faced with a tax liability.

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[25] *See* IRS Pub. 4731. Insolvency is the exclusion most likely to benefit low income taxpayers who have received a 1099-C as the result of the expiration of the 36 month testing period.
[26] E-mail from Kathy Davis, W&I C&L Outreach Communication, Internal Revenue Service, to Phil Rosenkranz, LITC Director, Legal Aid Society of Milwaukee (Feb. 11, 2013, 03:24 PM CST) (on file with the authors).
[27] *Id.* at p. 21.
[28] Nat'l Taxpayer Advocate, 2007 Annual Report to Congress, Vol. I, at MSP #2

Moreover, the insolvency exception is notoriously difficult for taxpayers to understand and access. Despite recent improvements to Form 982, which greatly simplify accessing the insolvency exception, many eligible taxpayers still are unable to use the insolvency exception to exclude discharge of indebtedness income. As discussed above, the VITA and TCE sites are not able to deal with the insolvency exclusion. The Taxpayer Advocate's study on the issuance of 1099-Cs suggested that taxpayers do not understand the exclusion. The study reviewed a random sample of tax accounts of taxpayers who received the IRS notice for failing to report cancellation of debt income.[29] TAS found that nearly all of the taxpayers who had received the notice had claimed the Earned Income Tax Credit and met the definition of low income; many of these taxpayers should have been able to exclude the discharge of indebtedness income due to insolvency. However, half of those taxpayers did not respond to IRS's notice at all. Most of the other half simply agreed to the assessed deficiency. This suggests that the taxpayers affected by the 1099-Cs are not receiving effective assistance to deal with these matters.

Eliminating the 36 month testing period, in addition to the other benefits previously mentioned, would reduce the number of low income taxpayers who are facing tax liability that they would not otherwise owe simply because they are low income and lack the resources to deal with an information return reporting discharge of indebtedness income.

[29] 2010 Nat'l Taxpayer Advocate Serv., Annual Report to Congress, Volume I, at 155.

CREDITORS SHOULD NOT HAVE THE OPPORTUNITY TO USE THE ISSUANCE OR THREATENED ISSUANCE OF A 1099-C AS A COLLECTION TOOL TO COMPEL DEBTOR PAYMENTS

The result of IRS's current position that creditors may issue a 1099-C and continue with debt collection activities[30] is widespread confusion among taxpayers and deception by creditors.[31] Consumers may find themselves in the position of having paid income tax on the forgiven debt and facing garnishment of their wages or other successful collection of the debt, paying tax on an entirely imaginary economic benefit.[32] Or they may find themselves simultaneously litigating the amount of a debt and facing a 1099-C for the same debt.[33] The current requirement that creditors must report debt as cancelled after three years of non-payment without any concomitant requirement that the debt actually be discharged must be repealed.[34]

Taxpayers who receive 1099-Cs often assume, erroneously, that the debt is, in fact, cancelled and forgiven. In some cases, courts have agreed, and used the issuance of

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[30] 26 C.F.R. § 1.6050P-1(b)(2)(iv). *See* I.R.S. Priv. Ltr. Rul. 2005-0208 (Dec. 30, 2005) ("Section 6050P and the regulations do not prohibit collection activity after a creditor reports by filing a Form 1099-C."); I.R.S. Priv. Ltr. Rul. 2005-0207 (Dec. 30, 2005) ("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.").

[31] *See, e.g.,* Amtrust Bank v. Fossett, 224 P.3d 935, 937 n. 2 (Ariz. Ct. App. 2009) ("By providing for issuance of a form called 'Cancellation Of Debt' even when a lender may not intend to release debt, 26 C.F.R. § 1.6050P is all but certain to confuse borrowers who receive the form under those circumstances."); Complaint at ¶ 7, Diallo v. APIM, LLC, No. 12 CV-5193 (E.D. N.Y. Oct. 16, 2012) (debt buyer attempting to collect on debt after statute of limitations expired; debt buyer threatened to report the debt to the IRS if the homeowner did not pay up).

[32] *See, e.g. In re* Crosby, 261 B.R. 470 (Bankr. D. Kan. 2001) (describing the experience of two debtors who experienced garnishment of their wages after they had received a 1099-C).

[33] *See* Motion to Vacate Deficiency Judgment, JP Morgan Chase Bank, NA v. House, No. 10-23754 (Cook Cty. Cir. Ct., Ill., Dec. 10, 2012); E-mail with Daniel P. Lindsey, Supervising Attorney, Legal Assistance Foundation (Mar. 1, 2013) (lender issued a 1099-C for a deficiency judgment while contesting the mortgagor's motion to set aside the deficiency judgment); Posso v. Asta Funding, Inc., 2007 WL 3374400 (N.D. Ill. Nov. 9, 2007).

[34] *See* 2010 National Taxpayer Advocate Annual Report 383-386 (advocating that the passage of three years should not by itself be a triggering event for reporting, because it can place taxpayers in the position of paying tax and facing collection activities at the same time).

a 1099-C as proof that the debt has, in fact, been forgiven and further collection activity on that account is barred.[35]

But more often, courts have found that creditors may continue collection after the issuance of a 1099-C. Even if the taxpayer has already paid income tax on the discharged debt, a debt collector or creditor can resume collection activity upon filing an amended 1099-C.[36] One case even suggested debt collectors could continue with collection activities without amending the 1099-C if the original 1099-C included a statement that debt collection activities would be ongoing.[37] This muddled state of the law leaves consumers uncertain as to the status of their obligations.

This muddle is exacerbated by the widespread involvement of debt buyers in the collection of debts, particularly old debts.[38] Debt buyers are notorious for engaging in abusive practices, including collecting on debts that are time-barred and debts for which the debt buyer lacks proof of the validity or existence of the debt.[39] Debt buyers are not

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[35] *See, e.g., In re* Welsh, 2006 WL 3859233, at *1-3 (Bankr. E.D. Pa. Oct. 27, 2006) (denying proof of claim in bankruptcy); *In re* Crosby, 261 B.R. 470 (Bankr. D. Kan. 2001) (same); Franklin Credit Mgmt. Corp. v. Nicholas, 812 A.2d 51 (Conn. App. Ct. 2002) (dismissing foreclosure). *Cf.* Amtrust Bank v. Fossett, 224 P.3d 935 (Ariz. Ct. App. 2009) (upholding summary judgment finding that creditor's issuance of 1099-C created a genuine issue of material fact as to whether the debt had been discharged).

[36] *See, e.g.,* Hamilton v. United States, 2005 WL 2671373 (S.D. Ohio Oct. 19, 2005); *In re* Zilka, 407 B.R. 684 (Bankr. W.D. Pa. 2009) (allowing creditor's claim in bankruptcy over debtor's protestations that the debt had been reported as discharged to the IRS, and income tax paid; finding that any prejudice in the prior payment of income taxes on the debt could be undone by requiring the creditor to issue an amended 1099-C); *In re* Crosby, 261 B.R. 470 (Bankr. D. Kan. 2001) (stating that creditor could resume debt collection once an amended 1099-C was issued); Far East Nat'l Bank v. Nolan Fin. Corp., 2005 WL 2671530(Cal. Ct. App. Oct. 20, 2005); International Commercial Bank v. L&L, Inc., 2005 WL 605056 (Cal. Ct. App. Mar. 16, 2005); Leonard v. Old Nat'l Bank Corp., 837 N.E. 2d 543 (Ind. Ct. App. 2005); Hathaway v. Tompkins, 794 N.Y.S.2d 899 (N.Y. Sup. Ct. 2005); Chivaho Credit Union v. McGuire, 2012 WL 6212706 (Ohio Ct. App. Nov. 28, 2012).

[37] Debt Buyer's Ass'n v. Snow, 481 F. Supp. 2d 1 (D.D.C. 2006).

[38] *See, e.g.,* Connecticut National Bank v. Rehab Associates, 300 Conn. 314 (2011) (reversing judgment for debt buyer attempting to collect on 20 year old mortgage foreclosure deficiency, despite settlement agreement reached 18 years previously).

[39] *See* Complaint at ¶ 7, Diallo v. APIM, LLC, No. 12 CV-5193 (E.D. N.Y. Oct. 16, 2012) (debt buyer attempting to collect on debt after statute of limitations expired; debt buyer threatened to report the debt to the IRS if the homeowner did not pay up). *See generally* Rick Jurgens & Robert J. Hobbs, Nat'l Consumer L. Ctr., The Debt Machine: How the Collection Industry Hounds Consumers and Overwhelms the Courts

required to comply with the testing requirement of 6050P, nor are they barred from collecting on a debt for which the original creditor and financial institution has issued a 1099-C. Taxpayers who rely on a 1099-C issued by a financial institution and report and recognize the forgiven debt as income on their tax return may find themselves nonetheless facing harassing calls and a debt collection lawsuit from a debt buyer who has no knowledge of nor responsibility for the issuance of the previous 1099-C.[40]

Creditors have used the threat of a 1099-C to collect on debts.[41] Attached as Exhibits 2 and 3 are two examples. These tactics may violate the general prohibitions in the federal Fair Debt Collection Practices Act against false or misleading representations in debt collection.[42] Creditors have also issued 1099-Cs in retaliation for assertion of rights under the Fair Debt Collection Practices Act.[43] Some courts have found that these false and abusive 1099-Cs nonetheless are not subject to challenge under the Fair Debt Collection Practices Act.[44] IRS should not facilitate practices that run afoul of the spirit of federal and state consumer protection laws.

(2010), *available at* http://www.nclc.org/images/pdf/debt_collection/debt-machine.pdf; National Consumer Law Center, Fair Debt Collection § 1.5.4.5 (7th ed. 2011 and Supp.).

[40] *See, e.g.,* Complaint at ¶ 7, Diallo v. APIM, LLC, No. 12 CV-5193 (E.D. N.Y. Oct. 16, 2012) (debt buyer attempting to collect on debt after statute of limitations expired; debt buyer threatened to report the debt to the IRS if the homeowner did not pay up).

[41] *See, e.g.,* Complaint at ¶ 7, Diallo v. APIM, LLC, No. 12 CV-5193 (E.D. N.Y. Oct. 16, 2012) (debt buyer attempting to collect on debt after statute of limitations expired; debt buyer threatened to report the debt to the IRS if the homeowner did not pay up); Jacob Barron, *Leveraging Uncle Sam: Getting the Threat of the IRS Behind Your Collection Effort*, Nat'l Ass'n of Credit Management, Business Credit , June 2008, at 1 (trade publication recommending threatening the issuance of a 1099-C in order to facilitate collections); E-mail from Tara Goodwin, Attorney (Mar. 1, 2013). *Cf.* Wagner v. Client Servs., Inc., 2009 WL 839073 (E.D. Pa. Mar. 26, 2009) (finding FDCPA violation where offer of settlement advised that a if more than $600 in debt was forgiven, a 1099-C would be issued, without a determination as to whether any exclusions would apply).

[42] 15 U.S.C. § 1692e.

[43] E-mail from William J. Purdy, Attorney (Mar. 1, 2013).

[44] *See* Posso v. Asta Funding, Inc., 2007 WL 3374400 (N.D. Ill. Nov. 9, 2007) (finding that 1099-C issued for incorrect amount after settlement of litigation regarding amount of debt not subject to challenge under FDCPA).

CONCLUSION

We thank IRS for affording us this opportunity to comment. We ask that IRS remove the 36-month testing period reporting requirement in the regulation. We also ask that IRS specifically provide that creditors are barred from issued a 1099-C unless the debt has been extinguished.

Requiring issuance of a 1099-C following the expiration of a 36 month testing period is arbitrary as it bears no relation to whether or not the underlying debt has actually been discharged, whether the creditor intends to discharge it, and when discharge will occur, if at all. Unless the debt has been discharged, the debtor taxpayer does not recognize the economic benefit that supports including discharged indebtedness in gross income. The other seven identifiable events in the Treasury Regulation that require a creditor to issue a 1099-C are explicitly tied to a discharge of indebtedness or extinguishment of the debt. The 36 month testing period stands alone in arbitrarily imposing tax consequences.

We would be glad to respond to questions or concerns IRS might raise in connection with these comments.

CHASE

Exhibit 1

October 27, 2009

VIA U.S. MAIL:

Attn: Susan Morgenstern
The Legal Aid Society of Cleveland
1223 West Sixth Street
Cleveland, OH 44113

Re: Form 1099-C Cancellation of Debt for [redacted]
Acct. No. [redacted]

Dear Ms. Morgenstern:

I have reviewed a copy of your letter dated October 16, 2009. The Form 1099-C filed with respect to [redacted]'s Refund Anticipation Loan was not erroneous and therefore, JPMorgan Chase Bank, N.A. ("Chase") does not believe a correction of the Form is warranted.

There are several different identifiable events that may cause the filing of a Form 1099-C under the applicable Department of the Treasury regulations. [redacted]'s Form 1099-C was filed in accordance with 26 C.F.R. § 1.6050P-1(b)(2)(i)(H) because Chase had not received a payment on the Refund Anticipation Loan from [redacted] during the period described under such regulation and Chase had not engaged in significant collection activity during such time. The automated annual mailing of a letter such as the December 2008 letter is not considered significant collection activity under the regulation.

Please also note that even upon the filing of the Form 1099-C for this reason, the debtor remained legally obligated to pay the debt.

Please contact me at (312) 732-2082 if you have further questions.

Sincerely,

Rachel Ahn
Assistant General Counsel

JPMorgan Chase & Co. • Mail Code IL1-0290, 10 South Dearborn St. 6th Floor, Chicago, IL 60603-2003
Telephone: 312 732 2082 • Facsimile: 312 732 3596
rachel.c.ahn@chase.com

The law does not require our office to wait until the end of the thirty-day period before commencing suit against you in Connecticut to collect this debt. If, however, you request proof of the debt or the name and address of the original creditor within the thirty day time period that begins upon our receipt of this notice, the law requires our office to stop our collection efforts to collect the debt until we mail the requested information to you. **This is an attempt to collect a debt and this letter constitutes a communication from a debt collector. Any information obtained will be used for that purpose.**

To the extent your original obligation was discharged, or is subject to an automatic stay of bankruptcy under Title 11 of the United States Code, this notice is for compliance and/or informational purposes only and does not constitute an attempt to collect a debt or to impose personal liability for such obligation. Our client may report information about your account to credit bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report. We may also report this to the IRS as Debt Cancellation Income pursuant to IRS Reg. S1.61-12 if payment is not received.

Please keep in mind that if litigation against the debtor proceeds to judgment in the creditor's favor, under Connecticut law the creditor has certain methods at its disposal to obtain actual payment in satisfaction of the judgement rendered. For example, the creditor can question a judgment debtor under oath about available assets. Further, liens can be placed on any real property owned by the judgment debtor.

The creditor can also request the court to order the judgment debtor to make installment payments to satisfy the judgment. If payments are then not made in accordance with the court order, an execution can be issued against the judgment debtor's wages, personal property, or bank accounts so that the creditor can satisfy the debt out of the judgement debtor's wages, bank accounts, or non-exempt personal property. Under Connecticut law, some property is exempted from execution by statute.

If you are represented by an attorney in regards to this debt, please notify this office in writing with his or her name, address and phone number. If you wish to make arrangements to pay this debt, you or your agent or representative may contact our office at (203) 348-2000. We request payment in full within 7 days of the receipt of this letter. Thank you for your time and consideration.

Very truly yours,
Law Offices of Frank N. Peluso, P.C.

By: John A. Locus, Esq.

APIM, LLC
22568 Mission Blvd., Suite 525
Hayward, CA 94541
(888)969-3888
support@apimllc.com

[redacted]

October 24, 2011

Original Creditor: BANK OF AMERICA
Original Account Number: [redacted]
APIM File Number: [redacted]
Total Balance Due: $6,793.49

Dear [redacted]
We have made multiple attempts to work with you on concluding your debt to APIM. This includes zero interest installment program with low monthly payment, and discounted settlement in full. At this time APIM must look to determine the status of all unconcluded accounts.

Your account as of today is considered unresolved, and we have prepared the Form 1099-C and may report to the IRS if the account is not satisfied shortly. Please see the attached draft copy of the Form 1099-C. At a 30% tax bracket, this is approximately $2,038.05 in taxes you will be owing to the US Treasury for the year 2011.

Upon receipt of this letter, please contact us right away. We are willing to work out arrangements on your account if you contact us at (888)969-3888. Once the Form 1099-C is filed with the US Government, we will no longer be able to offer alternatives and/or settle your debt.

Sincerely,
APIM, LLC

Please include our file number on all correspondence.

P. O. Box 32
Hayward, CA 94543

October 24, 2011
Letter Code: [redacted]

Mail all correspondence and payments to:
APIM LLC
22568 Mission Blvd., Suite 525
Hayward, CA 94541

IF PAYING BY CREDIT CARD, COMPLETE ALL, SIGN AND RETURN.	
CHECK CARD USING FOR PAYMENT: [ ] VISA [ ] [ ] [ ]	
CARD NUMBER PLUS 3 DIGIT SECURITY CODE (on back of card)	EXP. DATE /
CARDHOLDER NAME CARDHOLDER SIGNATURE	AMOUNT $

Total Due: $6,793.49
APIM File Number: [redacted]

[redacted]