

Client Alert

Current Issues Relevant to Our Clients

November 20, 2014

IRS Proposes Removal of 36-Month Rule for Reporting Cancellation of Debt

On October 15th, the IRS proposed a change to the regulations which would eliminate the requirement of a creditor to report cancellation of debt income on Form 1099-C after not receiving payment for 36 months.

Under Section 6050P(a) of the Code, applicable entities that discharge the indebtedness of any person during any calendar year in an amount of \$600 or more shall make a return of certain information, including the name and address and Tax Identification Number of the person whose indebtedness was discharged and the date of the discharge. The filing should be made on information return Form 1099-C, Cancellation of Debt.

A discharge of indebtedness is deemed to have occurred if and only if there has occurred an identifiable event. The list of identifiable events includes, among other things, (1) a discharge of indebtedness under bankruptcy, (2) a discharge of indebtedness pursuant to an agreement between an applicable entity and a debtor to discharge indebtedness at less than full consideration and (3) 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.

The current regulations also contain a 36-month rule, which provides that there is a rebuttable presumption that an identifiable event has occurred if no payment is received on an indebtedness during a certain testing period. The testing period is 36 months, ending at the close of the year, 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 may be rebutted by the creditor if the creditor or its agent has engaged in significant, bona fide collection activity at any time during the year, or if facts and circumstances existing as of January 31st of the year following expiration of the 36-month period indicate that the indebtedness has not been discharged.

The 36-month rule has been a subject of discussion by the IRS and the industry since its introduction in 1996. It was originally added to the final 6050P regulations in response to concerns of creditors that the facts and circumstances approach in the proposed regulations was unclear regarding the effect of continuing collection activity. Creditors had suggested a requirement for reporting after a fixed time period during which there had been no collection efforts.

However, the rule causes confusion. All the other identifiable events are specific occurrences that typically result from an actual discharge of indebtedness. By contrast, the 36-month rule may trigger a responsibility to report cancellation of indebtedness to the IRS while the creditor continues attempts to collect the debt. Creditors and debtors are unsure whether creditors can lawfully continue collection efforts after issuing the Form 1099-C. Furthermore, Treasury Regulation 1.6050P-1(e)(9) provides that no additional reporting is required if a subsequent identifiable event occurs. Therefore, if the Form 1099-C is issued before the debt is actually discharged, the IRS will receive no notification when it is subsequently discharged, thus reducing the IRS's ability to collect tax on discharge of indebtedness income.

In 2012, the Treasury Department and the IRS requested comments from the public regarding whether to remove or modify the 36-month rule. They received 10 comments, all of which recommended removal or revision of the rule. Accordingly, on October 15, 2014, the IRS issued proposed regulations that would remove the 36-month rule entirely. In other words, if no other identifiable event occurred, a creditor would no longer be required to issue a 1099-C Cancellation of Debt Form at the expiration of the 36-month non-payment testing period. Comments and requests for public

hearing on these proposed regulations must be received by January 13, 2015.

The proposed removal of the 36-month rule will not be in effect until the change in the rule is finalized. Therefore, creditors should continue to report cancellation of debt under the 36-month rule at this time, but watch for further updates to come soon.

[For More Information](#)

For more information, please contact [Paul Carman](#) (312.845.3443), [Christie Galinski](#) (312.845.3431) or your primary Chapman attorney, or visit us online at [chapman.com](#).

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