T.D. 8654

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Information Reporting for Discharges of Indebtedness

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the information reporting requirements of applicable financial entities for discharges of indebtedness. The final regulations reflect changes to the Internal Revenue Code of 1986 (Code) made by section 13252 of the Omnibus Budget Reconciliation Act of 1993 (the Act). The final regulations affect certain financial institutions and federal executive agencies.

DATES: These regulations are effective December 22, 1996.

For dates of applicability, see §1.6050P–1(h).

FOR FURTHER INFORMATION CONTACT: Sharon L. Hall (timing and amount of discharge) at (202) 622-4930 or Michael F. Schmit (other issues) at (202) 622-4960, both of the Office of Assistant Chief Counsel (Income Tax and Accounting). Neither telephone number is toll-free.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1419. Responses to this collection of information are required for the IRS to monitor whether discharged debtors are properly complying with tax laws respecting cancellations of indebtedness.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The time estimates for the reporting requirements contained in these final regulations are reflected in the burden estimates for Form 1099–C.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax information are confidential, as required by 26 U.S.C. 6103.

Background

Section 6050P was added to the Code by section 13252 of the Act. Section 6050P requires certain financial entities to report discharges of indebtedness of $600 or more during any calendar year, and requires reporting entities to make a return at such time and in such form as the Secretary may by regulations prescribe.

On December 27, 1993, temporary regulations (TD 8506 [1994–1 C.B. 286]) relating to the reporting of discharge of indebtedness under section 6050P were published in the Federal Register (58 FR 68301). A notice of proposed rulemaking (IA–63–93 [1994–1 C.B. 803]) cross-referencing the temporary regulations was published in the Federal Register for the same day (58 FR 68337).

Written comments were received in response to the notice of proposed rulemaking. Fourteen speakers provided testimony at a public hearing held on March 30, 1994. In response to the comments and testimony, the IRS and Treasury issued Notice 94–73 (1994–2 C.B. 553), providing interim relief from penalties for failure to comply with certain of the reporting requirements of the temporary regulations. The Notice provided that, with respect to a discharge of indebtedness occurring before the later of January 1, 1995, or the effective date of the final regulations under section 6050P, no penalties would be imposed for the failure to report a discharge of indebtedness:

Section 6050P.—Returns Relating to the Cancellation of Indebtedness by Certain Entities

26 CFR 1.6050P–1: Information reporting for discharges of indebtedness by certain financial entities.

(a) Under title 11 of the United States Code;

(b) Resulting from the expiration of the statute of limitations for collection of an indebtedness;

(c) For an amount other than principal in the case of indebtedness arising in connection with a lending transaction; or

(d) For a person other than the primary (or first-named) debtor in the case of indebtedness incurred before January 1, 1995, that involves multiple debtors.

After consideration of all the comments, the proposed regulations under section 6050P are adopted, as revised by this Treasury decision, effective for discharges of indebtedness occurring after December 21, 1996. The temporary regulations and interim relief from penalties provided in Notice 94–73 remain in effect through December 21, 1996, at which time the temporary regulations are removed. However, no penalties will be imposed for the failure to report a discharge of indebtedness occurring after December 21, 1996, and before January 1, 1997, if the failure to report would have qualified for penalty relief under Notice 94–73 had the discharge occurred prior to December 22, 1996. Additionally, the final regulations provide that a financial entity subject to section 6050P may, at its discretion, apply any of the provisions of the final regulations to any discharge of indebtedness occurring on or after January 1, 1996, and before December 22, 1996. The comments and revisions to the proposed regulations are discussed below.

At the request of commentators, the IRS and Treasury are considering the issuance of guidance providing uniform procedures for requesting extensions of time within which to file information returns with the IRS and related statements to taxpayers. This guidance, if issued, would apply to the information reporting requirements set forth in this Treasury decision.

Explanation of Revisions and Summary of Comments

1. *Identifiable events*

Comments were received relating to the issue of when an indebtedness is discharged for purposes of section 6050P. Under the temporary and proposed regulations, indebtedness is considered discharged, and reporting is required, upon the occurrence of an identifiable event indicating that the indebtedness will never have to be repaid by the debtor, taking into account all of the facts and circumstances. The temporary and proposed regulations list three identifiable events, but make clear that the three items do not represent an exclusive list of events requiring reporting.

Commentators objected to this facts and circumstances test, and stated that the final regulations should instead provide an exclusive list of reporting events. The comments indicated that creditors do not have the resources to weigh all the facts and circumstances in order to determine whether a debt will never have to be repaid by the debtor.

In response to these comments, the final regulations provide that, for purposes of section 6050P, indebtedness is considered discharged, and reporting is required, only upon the occurrence of certain identifiable events. The regulations contain an exclusive list of eight identifiable events, and provide that, in the absence of the occurrence of one of these events, a Form 1099–C is not required to be filed.

A. *Discharges of indebtedness in bankruptcy*

Commentators objected to the requirement in the temporary and proposed regulations relating to the reporting of a discharge of indebtedness in bankruptcy. The commentators stated that the obligation to report debts discharged in bankruptcy was extremely burdensome due to the large number of information returns that these bankruptcies would generate. These commentators also stated that some lenders do not receive information regarding a debtor's bankruptcy discharge in the normal course of business.

Commentators also objected to the requirement to report debts discharged in bankruptcy because income from a discharge in bankruptcy is excludable under section 108(a)(1)(A). Additionally, while acknowledging that section 108(b) generally requires the reduction of tax attributes for amounts of cancellation of indebtedness income excluded under section 108(a), these commentators indicated that the majority of bankruptcies involve consumer debt, the discharge of which is unlikely to give rise to attribute reduction. Thus, they contended that the reporting of consumer debts discharged in bankruptcy will not further the purposes of section 6050P.

Finally, based on language in section 6050P, commentators contended that the IRS and Treasury lacked authority to require reporting in bankruptcy. Under section 6050P(a), ''any applicable financial entity which discharges … the indebtedness of any person'' is subject to the rules of section 6050P. Commentators argued that creditors should not be subject to the rules of section 6050P for debts discharged in bankruptcy because it is the bankruptcy court, not the creditor, that discharges the debt.

In promulgating the temporary regulations, the IRS and Treasury fully considered the issue of whether bankruptcy discharges could be excluded from the reporting requirement. The legislative history to section 6050P states that ''information returns are required regardless of whether the debtor is subject to tax on the discharged debt. For example, Congress does not expect reporting financial institutions and agencies to determine whether the debtor qualifies for an exclusion under section 108.'' H.R. Conf. Rep. No. 213, 103d Cong., 1st Sess. 1, 671 (1993). This language indicates that Congress intended that discharges resulting in excluded income (such as bankruptcy discharges) be reported.

Accordingly, the IRS and Treasury do not believe that a requirement to report debts discharged in bankruptcy is outside the scope of section 6050P. In enacting section 6050P, Congress intended to increase debtor compliance in reporting discharges of indebtedness. With respect to the tax consequences to the debtor, it generally makes no difference whether the debt is voluntarily discharged by the financial entity, or discharged by a court order. Further, the creditor is receiving an amount that is less than the amount of the outstanding indebtedness whether the debt is voluntarily discharged or ordered to be discharged by a court. Thus, the language ''any applicable financial entity which discharges … indebtedness'' should not be narrowly construed to exclude instances in which a debt is ordered to be discharged or is discharged by operation of law.

The IRS and Treasury believe that an objective of the legislative history quoted above is that information reporting under section 6050P not impose an undue burden on filers by requiring determinations regarding whether discharges result in income to debtors. However, the legislative history does not preclude an exception for certain discharges in appropriate circumstances. Accordingly, in response to the above concerns of the commentators, the final regulations provide an exception from reporting in the case of certain bankruptcy discharges. Under the final regulations, indebtedness discharged in bankruptcy is required to be reported only if the creditor knows that the debtor incurred the indebtedness for business or investment purposes. Therefore, reporting is not required for consumer debts discharged in bankruptcy or in cases in which the creditor is not aware of the purpose for the borrowing or that purpose is not clear. Information relating to whether a debt was incurred for business or investment purposes will be available to a creditor in some cases, such as those in which loan documents require the borrower to state the purpose of the loan. This limited reporting of debts discharged in bankruptcy will exclude information returns relating to consumer debt, while retaining reporting for those discharges most likely to involve the reduction of tax attributes under section 108(b). Pursuant to Notice 94–73, no penalties will be imposed for the failure to report any indebtedness discharged before December 22, 1996, in bankruptcy. Additionally, no penalties will be imposed for the failure to report any indebtedness discharged after December 21, 1996, and before January 1, 1997, in bankruptcy, since the failure to report would have qualified for penalty relief under Notice 94-73 had the discharge occurred prior to December 22, 1996.

B. *Expiration of statute of limitations for collection*

Under the temporary and proposed regulations, an identifiable event includes a cancellation or extinguishment by operation of law that renders a debt unenforceable, such as the expiration of the statute of limitations for collection of an indebtedness.

Comments were received relating to the requirement to report indebtedness discharged as a result of the expiration of the statute of limitations. Commentators argued that expiration of the statute of limitations should not be an identifiable event because of the recordkeeping and other administrative burdens that are created by such a rule. Commentators noted that the statute of limitations for collection of debt varies from state to state, and that debtors may relocate and be subject to the rules of multiple jurisdictions. Further, they contended, an isolated payment by a debtor will frequently restart the running of the statute of limitations. According to the commentators, making lenders track the expiration of the statute of limitations for reporting purposes would require special computer applications not needed for any other creditor function, require legal expertise in the collection department, and be very costly.

As a legal matter, commentators argued that the statute of limitations is an affirmative defense, and affects only judicial enforceability of the obligation. Most commentators indicated that collection activity routinely continues after the expiration of the statute of limitations. The temporary and proposed regulations list collection activity on the part of the creditor as a factor to be considered in determining whether debt has been discharged. Thus, even under the temporary and proposed regulations, expiration of the statute of limitations would rarely mark the date on which debt is considered discharged, because collection activity routinely continues after that date.

In response to these comments, the final regulations provide that expiration of the statute of limitations for collection of an indebtedness is an identifiable event for which a Form 1099–C is required to be filed only if, and at such time as, a debtor's affirmative defense of the expiration of the statute of limitations is upheld in a final judgment or decision of a judicial proceeding, and the period for appealing the judgment or decision has expired.

C. *Other discharges by operation of law*

As stated above, the temporary and proposed regulations provide that an identifiable event includes a cancellation or extinguishment by operation of law that renders a debt unenforceable (such as the expiration of the statute of limitations for collection of the indebtedness). The temporary and proposed regulations do not specify all of the circumstances requiring reporting under this identifiable event.

In order to further the goal of providing an exclusive list of reporting events, the final regulations specify those discharges occurring by operation of law that are required to be reported under section 6050P. In addition to the statute of limitations identifiable event previously discussed, the events relating to operation of law that must be reported are (i) 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 section 368(a)(3)(A)(ii); (ii) a cancellation or extinguishment of an indebtedness upon the expiration of a statutory period for filing a claim or commencing a deficiency judgment proceeding; (iii) a cancellation or extinguishment of an indebtedness that renders a debt unenforceable pursuant to a probate or similar proceeding; and (iv) 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. This final event relating to an election of foreclosure remedies will require reporting only where a mortgage lender or holder is barred by local law from pursuing a deficiency judgment or note collection proceeding following exercise of a power of sale contained in a mortgage or deed of trust.

A discharge of indebtedness occurring by operation of law not enumerated above is not required to be reported under the final regulations.

D. *Collection activity*

Commentators indicated that the temporary and proposed regulations were unclear regarding the effect of continuing collection activity on the requirement to report under section 6050P. The temporary and proposed regulations provide that collection activity is one of the facts and circumstances to be taken into account in determining whether a discharge of indebtedness has occurred. The commentators argued that the final regulations should clarify that reporting is not required prior to termination of collection efforts on the part of the creditor.

In response to these comments, the final regulations address the effect of collection efforts on the requirement to report under section 6050P. Under the final regulations, an identifiable event occurs and reporting is required upon a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge indebtedness. For this purpose, a defined policy may be either a written policy or a creditor's established business practice.

Additionally, under the final regulations, there is a rebuttable presumption that an identifiable event has occurred during a calendar year if a creditor has not received a payment on an indebtedness at any time during a 36-month testing period ending at the close of the year. This presumption is 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 testing period indicate that the indebtedness has not been discharged. Under the final regulations, significant, bona fide collection activity does not include merely nominal or ministerial collection action, such as an automated mailing. Further, 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.

E. *Other reportable discharges*

Under the temporary and proposed regulations, an identifiable event includes an agreement between the applicable financial entity and the debtor to discharge an indebtedness, provided that the last event necessary to effectuate the discharge has occurred. The final regulations retain this reporting requirement, restating that an identifiable event includes a discharge of indebtedness pursuant to an agreement between an applicable financial entity and a debtor to discharge indebtedness at less than full consideration. As under the temporary regulations, this identifiable event will not occur until the last event necessary to effectuate the discharge has occurred.

The final regulations also provide that a discharge of indebtedness occurring before the date on which an identifiable event occurs may, at the creditor's discretion, be reported under section 6050P.

2. *Definition of indebtedness*

Commentators objected to the broad definition of indebtedness provided in the temporary and proposed regulations. The temporary and proposed regulations provide that, for purposes of reporting the amount of indebtedness discharged, an indebtedness is any amount owed to the creditor including principal, interest, penalties, fees, administrative costs, and fines, to the extent the amount constitutes an indebtedness under section 61(a)(12). Commentators argued that this definition is overly broad and should be amended to include principal only (or the primary indebtedness in the case of a non-lending transaction). In response to these comments, the final regulations provide certain exceptions relating to the reporting of amounts other than stated principal.

A. *Reporting of interest*

Commentators offered two main objections to the reporting of interest. First, commentators stated that reporting interest was burdensome because interest is not tracked by lenders once indebtedness is written off or placed on nonaccrual status on the lender's books. Second, commentators suggested that reporting of interest would be of marginal benefit to the IRS because in many cases discharged interest may be excluded from gross income under sections 108(e)(2) and 111.

In response to these comments, and in an effort to reduce the information reporting burden on affected filers, the final regulations do not require the reporting of amounts of discharged interest (whether or not arising in connection with a lending transaction), despite the fact that some discharged interest will give rise to gross income. However, at the option of the applicable financial entity, interest may be included in the amount reported. Additionally, as provided in Notice 94–73, in the case of a discharge of indebtedness before December 22, 1996, no penalties will be imposed for failure to report an amount other than principal in the case of indebtedness arising in connection with a lending transaction.

B. *Penalties, fees, administrative costs, and fines*

Commentators also argued that, like interest, penalties, fees, administrative costs, and fines are not tracked by lenders once an indebtedness is written off on the books of the lender. Thus, they contended, tracking these amounts would require additional computer programming and recordkeeping, and would be very costly. With respect to lending transactions, the IRS and Treasury have concluded that the benefits that would be derived from requiring the reporting of penalties, fees, administrative costs, and fines are outweighed by the burden associated with the requirement. Accordingly, the final regulations provide that, in the case of a lending transaction, only discharged amounts of stated principal are required to be reported. In the case of non-lending transactions, the amount owed, such as a fee, fine, or penalty, is reportable if discharged.

3. *Reporting for multiple debtors*

Commentators recommended that the multiple debtor rules of the temporary and proposed regulations be amended so that reporting is required only with respect to the primary or first-named debtor on the lender's account. The rationale for this approach is that, in general, lenders track loans involving multiple debtors only by the name of the borrower of record, and thus, the information required to be reported under section 6050P (*e.g.*, the name, address, and taxpayer identification number (TIN)) for debtors other than the primary debtor is generally not available to lenders. In addition, the commentators pointed out that most other information return regulations require reporting only with respect to a single taxpayer (*e.g.*, §1.6050H–1 requires reporting only with respect to one designated interest payor even if multiple debtors are liable on a mortgage). Finally, these commentators stated that the majority of multiple debtor situations involve a husband and wife who will likely file a joint return, and therefore, requiring reporting for each debtor is not necessary.

The IRS and Treasury believe, however, that requiring reporting for multi-

ple debtors is consistent with section 6050P(a)(1), which provides that the reporting of a name, address, and TIN is required for *each person whose indebtedness was discharged*. Further, while reporting with respect to only one taxpayer is required under many information reporting sections of the Code, section 6050J, which is comparable to section 6050P in that it relates to the reporting of acquisitions and abandonments of property securing indebtedness, requires reporting for each person who is a borrower with respect to the secured indebtedness. Moreover, in Notice 94–73, the IRS addressed the concerns of commentators by providing that no penalties would be imposed for failure to report a discharge of indebtedness for other than the primary (or first-named) debtor in the case of indebtedness incurred before January 1, 1995, thus allowing creditors time to begin collecting the necessary information for all debtors in the case of indebtedness incurred after December 31, 1994. The final regulations incorporate this relief.

In order to reduce the information reporting burden on applicable financial entities, the final regulations contain two exceptions relating to multiple debtor reporting. In the case of indebtedness of less than $10,000 incurred on or after January 1, 1995, that involves multiple debtors, reporting is required only for the primary (or first-named) debtor. Additionally, to avoid duplication, the final regulations provide a husband/wife exception to the requirement for reporting in the case of multiple debtors. Under this exception, only one Form 1099–C must be prepared if the creditor knows, or has reason to know, that the co-obligors were husband and wife living at the same address when the indebtedness was incurred, and does not know or have reason to know that such circumstances have changed at the time of the discharge. These two exceptions apply to discharges of indebtedness after December 31, 1994.

The final regulations retain the rule of the temporary and proposed regulations relating to the amount to be reported with respect to each joint and several debtor.

4. *Multiple creditors/lending pools/ REMICs*

Commentators indicated that further guidance should be provided in the final regulations regarding section 6050P reporting obligations in the case of participation loans, lending pools, and other multiple-creditor situations. In response to these comments, the final regulations provide a general rule that, in the case of an indebtedness owned (or treated as owned for federal income tax purposes) by more than one creditor, each creditor that is an applicable financial entity must comply with the reporting requirements of this section with respect to any discharge of indebtedness of $600 or more allocable to such creditor. A creditor will be considered to have complied with the requirements of this section if a lead bank or other designee of the creditor complies on its behalf.

Comments were received advocating an exception from reporting for discharges of certain widely-owned securitized indebtedness. The commentators reasoned that the owners of widely-held securitized indebtedness will generally have no knowledge regarding when a discharge occurs, or the amount of discharged debt allocable to each owner. Further, commentators suggested that it is likely that a significant portion of such securitized indebtedness may be owned by persons that are not applicable financial entities and, therefore, are not subject to section 6050P.

The IRS and Treasury believe, however, that it would be inconsistent with the purpose of section 6050P to provide a general exception from reporting for such securitized indebtedness. Section 6050P is intended to increase the likelihood that a debtor will comply with the tax laws relating to discharge of indebtedness by requiring the reporting of that event to the IRS. The fact that indebtedness has been securitized and sold to numerous owners generally does not affect the tax consequences to the debtor upon a discharge of that indebtedness. Thus, the IRS and Treasury do not believe that a discharge of indebtedness should be excepted from section 6050P reporting simply because that indebtedness was part of a securitization arrangement.

Commentators also argued that the discharge of an indebtedness held by a real estate mortgage investment conduit (REMIC) should not be required to be reported under section 6050P. Because a REMIC is not an applicable financial entity, commentators contended that section 6050P should not apply upon a discharge of indebtedness held by a REMIC.

However, section 860F(e) provides that, for purposes of subtitle F of the Code (Procedure and Administration, including section 6050P), a REMIC is treated as a partnership and holders of residual interests in the REMIC are treated as partners. Under the final regulations, indebtedness owned by a partnership is treated as owned by the partners. Thus, arguably a discharge of REMIC indebtedness should be treated similar to partnership indebtedness and thus should be reported to the extent the residual owners of the REMIC are applicable financial entities.

Because the IRS and Treasury believe that further study of these issues is warranted, the final regulations reserve on the application of section 6050P to discharges of indebtedness held (1) in a pass-through securitized indebtedness arrangement, or (2) by a REMIC. For this purpose, a pass-through securitized indebtedness arrangement is any arrangement whereby one or more debt obligations are pooled and held for twenty or more persons whose interests in the debt obligations are undivided co-ownership interests that are freely transferrable. Co-ownership interests that are actively traded personal property (as defined in §1.1092(d)–1) are presumed to be freely transferrable and held by twenty or more persons. Pending issuance of further guidance, no penalties will be imposed for failure to report a discharge of indebtedness held under these circumstances. This relief from penalties does not extend to arrangements formed for a principal purpose of avoiding the reporting requirements of this section. The IRS and Treasury welcome comments regarding compliance with section 6050P in the case of pass-through securitized indebtedness arrangements and REMICs.

5. *Coordination of Form 1099–A and Form 1099–C*

The legislative history to section 6050P indicates that Congress intended that the IRS and Treasury coordinate reporting under section 6050P with the reporting required under section 6050J. Section 6050J requires information relating to foreclosures and abandonments of secured property to be reported on Form 1099–A.

The final regulations provide that if, in the same calendar year, a discharge

of indebtedness reportable under section 6050P occurs in connection with a foreclosure or abandonment of secured property reportable under section 6050J, it is not necessary to file both a Form 1099–A and a Form 1099–C for the same debtor. Under the final regulations, the filing requirements of section 6050J will be satisfied with respect to a debtor if, in lieu of filing a Form 1099–A, a Form 1099–C is filed in accordance with the instructions for the filing of that form. This coordinated filing provision applies to discharges of indebtedness after December 31, 1994.

6. *Direct or indirect subsidiary*

Commentators requested that the final regulations include a definition of a direct or indirect subsidiary for purposes of section 6050P. Section 6050P(c)(1)(C) provides that the definition of applicable financial entity includes a direct or indirect subsidiary of an entity described in section 6050P(c)(1)(A). In response to these comments, the final regulations provide that, for purposes of section 6050P(c)(1)(C), the term direct or indirect subsidiary means a corporation in a chain of corporations beginning with the entity described in section 6050P(c)(1)(A), if at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of all classes of stock, of such corporation is directly owned by the entity described in section 6050P(c)(1)(A), or by one or more other corporations in the chain.

7. *Other exceptions from reporting*

The IRS and Treasury received numerous comments advocating that the final regulations include exceptions from reporting with respect to certain discharges of indebtedness.

A. *Reporting for non-U.S. debtors*

Comments were received relating to the inclusion in final regulations of an exception for reporting discharges of indebtedness of certain foreign debtors. These comments noted that, in some cases, discharges of indebtedness that involve such debtors will not result in income that is taxable in the United States.

On the other hand, there clearly are cases in which a foreign person may be subject to U.S. tax with respect to a discharge of indebtedness. Because there is no clear guidance on which financial institutions may rely for purposes of determining whether a foreign person would be subject to U.S. tax with respect to cancellation of indebtedness income, it is not appropriate to provide a general exception for foreign persons. However, the IRS and Treasury are continuing to study the issue of whether reporting is necessary in the case of foreign debtors whose debt is discharged by foreign branches of U.S. financial institutions. Accordingly, pending the issuance of further guidance, no penalties will be imposed if an applicable financial entity fails to report a discharge of indebtedness of a foreign debtor by a foreign branch of the entity.

B. *Reporting where debt is acquired by related persons*

Comments were received requesting that the final regulations clarify whether reporting is required in circumstances in which there is a deemed discharge of indebtedness pursuant to the regulations under section 108(e)(4). Section 108(e)(4) and implementing regulations (see §1.108–2) provide that the acquisition of outstanding indebtedness by a person related to the debtor from a person who is not related to the debtor is treated as if the debtor had acquired the indebtedness and may result in a realization by the debtor of income from discharge of indebtedness. Commentators indicated that applicable financial entities often will be unaware that the conditions of section 108(e)(4) have been satisfied and that the debtor's indebtedness is considered to have been discharged. In response to these comments, the final regulations provide that no reporting is required under section 6050P in the case of a discharge of indebtedness under section 108(e)(4) unless the disposition of the indebtedness by the creditor was made with a view to avoiding the reporting requirements of this section.

C. *Reporting for guarantors of indebtedness*

Commentators also requested guidance on whether, and under what circumstances, a Form 1099–C must be filed for a guarantor of an indebtedness when the underlying indebtedness is discharged. The final regulations provide that, in the case of guaranteed debt, a guarantor is not treated as a debtor for purposes of reporting under section 6050P. Thus, reporting for guarantors is not required.

D. *Reporting for non-lending transactions*

A number of comments were received advocating an exception in the final regulations for discharges of indebtedness where the indebtedness is incurred in a non-lending transaction. Advocates of this exception argued that the primary reason applicable financial entities, and not all trade or businesses, were made subject to section 6050P is that financial entities have extensive involvement in lending transactions where the majority of discharges of indebtedness will occur. Commentators argued that when an applicable financial entity is a creditor as a result of a non-lending transaction, it should be treated in the same manner as a non-applicable financial entity with respect to that indebtedness, and not be subject to section 6050P if a discharge occurs.

Neither the language of section 6050P nor its legislative history provides any indication that Congress intended for discharges of non-lending indebtedness to be excluded from reporting. Moreover, it makes no difference in determining whether a debtor has income under section 61(a)(12) that the indebtedness was incurred in a non-lending transaction. Accordingly, the final regulations do not adopt this suggestion.

E. *Reporting of disputed liabilities*

The temporary and proposed regulations do not address the reporting requirements under section 6050P in the case of the settlement of a disputed liability. The preamble to the temporary regulations solicited public comment relating to this issue. Several commentators urged that the final regulations include an exception from reporting for settlements of bona fide disputed liabilities.

The determination regarding whether the settlement of a disputed liability results in discharge of indebtedness income under section 61(a)(12) is inherently factual. Thus, it continues to be the position of the IRS and Treasury that this issue should be addressed on a

case-by-case basis, rather than by these final regulations. Therefore, the final regulations do not provide an exception from reporting for disputed liabilities. Instead, resolution of the question of whether there may have been a discharge of indebtedness reportable under this section remains the obligation of the applicable financial entity. The IRS and Treasury recognize that a creditor and debtor may take inconsistent positions on this issue. The IRS does not intend to impose penalties for good faith failures to report settlements that constitute discharges of indebtedness.

8. *Miscellaneous comments*

Comments were also received relating to whether applicable financial entities have any information reporting obligations in instances where payments are received on previously discharged debts. In response to those inquiries, the final regulations clarify that no additional reporting or Form 1099–C correction is required if a creditor receives a payment of all or a portion of a discharged debt that has been reported to the IRS for a prior calendar year.

Comments were received respecting the TIN solicitation requirements of the temporary and proposed regulations. In response to those comments, the final regulations provide that a reasonable effort (rather than all reasonable efforts) must be made to obtain the correct name/TIN combination of the person whose indebtedness is discharged.

The IRS and Treasury received a number of other comments in addition to those summarized above. Some of the suggestions contained in the comments have been adopted in the final regulations. Other suggested changes were not adopted primarily because those suggestions were inconsistent with the purpose of the statute and its legislative history.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Sharon L. Hall and Michael F. Schmit, Office of the Assistant Chief Counsel (Income Tax and Accounting), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR Parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.6050P–1T and adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * *

Section 1.6050P–1 also issued under 26 U.S.C. 6050P. * * *

Par. 2. Sections 1.6050P–0 and 1.6050P–1 are added to read as follows:

§1.6050P–0 Table of contents.

This section lists the major captions that appear in §1.6050P–1.

§1.6050P–1 Information reporting for discharges of indebtedness by certain financial entities.

(a) Reporting requirement.
  (1) In general.
  (2) No aggregation.
  (3) Amounts not includible in income.
  (4) Time and place for reporting.
    (i) In general.
    (ii) Indebtedness discharged in bankruptcy.
(b) Date of discharge.
  (1) In general.
  (2) Identifiable events.
    (i) In general.
    (ii) Statute of limitations.
    (iii) Decision to discontinue collection activity; creditor's defined policy.
    (iv) Expiration of non-payment testing period.
  (3) Permitted reporting.
(c) Indebtedness.
(d) Exceptions from reporting requirement.
  (1) Certain bankruptcy discharges.
    (i) In general.
    (ii) Business or investment debt.
  (2) Interest.
  (3) Non-principal amounts in lending transactions.
  (4) Indebtedness of foreign persons held by foreign branches of U.S. financial institutions.
    (i) Reporting requirements.
    (ii) Definition.
  (5) Acquisition of indebtedness by related party.
  (6) Releases.
  (7) Guarantors and sureties.
(e) Additional rules.
  (1) Multiple debtors.
    (i) In general.
    (ii) Amount to be reported.
  (2) Multiple creditors.
    (i) In general.
    (ii) Partnerships.
    (iii) Pass-through securitized indebtedness arrangement.
      (A) Reporting requirements.
      (B) Definition.
    (iv) REMICs.
  (3) Coordination with reporting under section 6050J.
  (4) Direct or indirect subsidiary.
  (5) Use of magnetic media.
  (6) TIN solicitation requirement.
    (i) In general.
    (ii) Manner of soliciting TIN.
  (7) Recordkeeping requirements.
  (8) No multiple reporting.
(f) Requirement to furnish statement.
  (1) In general.
  (2) Furnishing copy of Form 1099–C.
  (3) Time and place for furnishing statement.

(g) Penalties.
(h) Effective dates.
(1) In general.
(2) Earlier application.

§1.6050P–1 Information reporting for discharges of indebtedness by certain financial entities.

(a) *Reporting requirement*—(1) *In general*. Except as provided in paragraph (d) of this section, any applicable financial entity (as defined in section 6050P(c)(1)) that discharges an indebtedness of any person (within the meaning of section 7701(a)(1)) of at least $600 during a calendar year must file an information return on Form 1099–C with the Internal Revenue Service. Solely for purposes of the reporting requirements of section 6050P and this section, 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. The return must include the following information—

(i) The name, address, and taxpayer identification number (TIN), as defined in section 7701(a)(41), of each person for which there was an identifiable event during the calendar year;

(ii) The date on which the identifiable event occurred, as described in paragraph (b) of this section;

(iii) The amount of indebtedness discharged, as described in paragraph (c) of this section;

(iv) An indication whether the identifiable event was a discharge of indebtedness in a bankruptcy, if known; and

(v) Any other information required by Form 1099–C or its instructions, or current revenue procedures.

(2) *No aggregation*. For purposes of reporting under this section, multiple discharges of indebtedness of less than $600 are not required to be aggregated unless such separate discharges are pursuant to a plan to evade the reporting requirements of this section.

(3) *Amounts not includible in income*. Except as otherwise provided in this section, discharged indebtedness must be reported regardless of whether the debtor is subject to tax on the discharged debt under sections 61 and 108 or otherwise by applicable law.

(4) *Time and place for reporting*—(i) *In general*. Except as provided in paragraph (a)(4)(ii) of this section, returns required by this section must be filed with the Internal Revenue Service office designated in the instructions for Form 1099–C on or before February 28 of the year following the calendar year in which the identifiable event occurs.

(ii) *Indebtedness discharged in bankruptcy*. Indebtedness discharged in bankruptcy that is required to be reported under this section must be reported for the later of the calendar year in which the amount of discharged indebtedness first becomes ascertainable, or the calendar year in which the identifiable event occurs.

(b) *Date of discharge*—(1) *In general*. Solely for purposes of this section, except as provided in paragraph (b)(3) of this section, indebtedness is discharged on the date of the occurrence of an identifiable event specified in paragraph (b)(2) of this section.

(2) *Identifiable events*—(i) *In general*. An identifiable event is—

(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 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 financial 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) The expiration of the non-payment testing period, as described in paragraph (b)(2)(iv) of this section.

(ii) *Statute of limitations*. In the case of an expiration of the statute of limitations for collection of an indebtedness, an identifiable event occurs under paragraph (b)(2)(i)(C) of this section only if, and at such time as, a debtor's affirmative statute of limitations defense is upheld in a final judgment or decision of a judicial proceeding, and the period for appealing the judgment or decision has expired.

(iii) *Decision to discontinue collection activity; creditor's defined policy*. For purposes of the identifiable event described in paragraph (b)(2)(i)(G) of this section, a creditor's defined policy includes both a written policy of the creditor and the creditor's established business practice. Thus, for example, a creditor's established practice to discontinue collection activity and abandon debts upon expiration of a particular non-payment period is considered a defined policy for purposes of paragraph (b)(2)(i)(G) of this section.

(iv) *Expiration of non-payment testing period*. 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) *Permitted reporting*. If a discharge of indebtedness occurs before the date on which an identifiable event occurs, the discharge may, at the creditor's discretion, be reported under this section.

(c) *Indebtedness*. For purposes of this section, indebtedness means any amount owed to an applicable financial entity, including stated principal, fees, stated interest, penalties, administrative costs and fines. The amount of indebtedness discharged may represent all, or only a part, of the total amount owed to the applicable financial entity.

(d) *Exceptions from reporting requirement*—(1) *Certain bankruptcy discharges*—(i) *In general*. Reporting is required under this section in the case of a discharge of indebtedness in bankruptcy only if the creditor knows from information included in the reporting entity's books and records pertaining to the indebtedness that the debt was incurred for business or investment purposes as defined in paragraph (d)(1)(ii) of this section.

(ii) *Business or investment debt*. Indebtedness is considered incurred for business purposes if it is incurred in connection with the conduct of any trade or business other than the trade or business of performing services as an employee. Indebtedness is considered incurred for investment purposes if it is incurred to purchase property held for investment, as defined in section 163(d)(5).

(2) *Interest*. The discharge of an amount of indebtedness that is interest is not required to be reported under this section.

(3) *Non-principal amounts in lending transactions*. In the case of a lending transaction, the discharge of an amount other than stated principal is not required to be reported under this section. For this purpose, a lending transaction is any transaction in which a lender loans money to, or makes advances on behalf of, a borrower (including revolving credits and lines of credit).

(4) *Indebtedness of foreign debtors held by foreign branches of U.S. financial institutions*—(i) *Reporting requirements*. [Reserved]

(ii) *Definition*. An indebtedness held by a foreign branch of a U.S. financial institution is described in this paragraph (d)(4) only if—

(A) The financial institution is engaged through a branch or office in the active conduct of a banking or similar business outside the United States;

(B) The branch or office is a permanent place of business that is regularly maintained, occupied, and used to carry on a banking or similar financial business;

(C) The business is conducted by at least one employee of the branch or office who is regularly in attendance at such place of business during normal working hours;

(D) The indebtedness is extended outside of the United States by the branch or office in connection with that trade or business; and

(E) The financial institution does not know or have reason to know that the debtor is a United States person.

(5) *Acquisition of indebtedness by related party*. No reporting is required under this section in the case of a deemed discharge of indebtedness under section 108(e)(4) (relating to the acquisition of an indebtedness by a person related to the debtor), unless the disposition of the indebtedness by the creditor was made with a view to avoiding the reporting requirements of this section.

(6) *Releases*. The release of a co-obligor is not required to be reported under this section if the remaining debtors remain liable for the full amount of any unpaid indebtedness.

(7) *Guarantors and sureties*. Solely for purposes of the reporting requirements of this section, a guarantor is not a debtor. Thus, in the case of guaranteed indebtedness, reporting under this section is not required with respect to a guarantor, whether or not there has been a default and demand for payment made upon the guarantor.

(e) *Additional rules*—(1) *Multiple debtors*—(i) *In general*. In the case of indebtedness of $10,000 or more incurred on or after January 1, 1995, that involves more than one debtor, a reporting entity is subject to the requirements of paragraph (a) of this section for each debtor discharged from such indebtedness. In the case of indebtedness incurred prior to January 1, 1995, and indebtedness of less than $10,000 incurred on or after January 1, 1995, involving multiple debtors, reporting under this section is required only with respect to the primary (or first-named) debtor. Additionally, only one return of information is required under this section if the reporting entity knows, or has reason to know, that co-obligors were husband and wife living at the same address when an indebtedness was incurred, and does not know or have reason to know that such circumstances have changed at the date of a discharge of the indebtedness. This paragraph (e)(1) applies to discharges of indebtedness after December 31, 1994.

(ii) *Amount to be reported*. In the case of multiple debtors jointly and severally liable on an indebtedness, the amount of discharged indebtedness required to be reported under this section with respect to each debtor is the total amount of indebtedness discharged. For this purpose, multiple debtors are presumed to be jointly and severally liable on an indebtedness in the absence of clear and convincing evidence to the contrary.

(2) *Multiple creditors*—(i) *In general*. Except as otherwise provided in this paragraph (e)(2), if indebtedness is owned (or treated as owned for federal income tax purposes) by more than one creditor, each creditor that is an applicable financial entity must comply with the reporting requirements of this section with respect to any discharge of indebtedness of $600 or more allocable to such creditor. A creditor will be considered to have complied with the requirements of this section if a lead bank, fund administrator, or other designee of the creditor complies on its behalf in any reasonable manner, such as by filing a single return reporting the aggregate amount of indebtedness discharged, or by filing a return with respect to the portion of the discharged indebtedness allocable to the creditor. For purposes of this paragraph (e)(2)(i),

any reasonable method may be used to determine the portion of discharged indebtedness allocable to each creditor.

(ii) *Partnerships*. For purposes of paragraph (e)(2)(i) of this section, indebtedness owned by a partnership is treated as owned by the partners.

(iii) *Pass-through securitized indebtedness arrangement*—(A) *Reporting requirements*. [Reserved]

(B) *Definition*. For purposes of this paragraph (e)(2)(iii), a pass-through securitized indebtedness arrangement is any arrangement whereby one or more debt obligations are pooled and held for twenty or more persons whose interests in the debt obligations are undivided co-ownership interests that are freely transferrable. Co-ownership interests that are actively traded personal property (as defined in §1.1092(d)–1) are presumed to be freely transferrable and held by twenty or more persons.

(iv) *REMICs*. [Reserved]

(3) *Coordination with reporting under section 6050J*. If, in the same calendar year, a discharge of indebtedness reportable under section 6050P occurs in connection with a transaction also reportable under section 6050J (relating to foreclosures and abandonments of secured property), an applicable financial entity need not file both a Form 1099–A and a Form 1099–C with respect to the same debtor. The filing requirements of section 6050J will be satisfied with respect to a borrower if, in lieu of filing Form 1099–A, a Form 1099–C is filed in accordance with the instructions for the filing of that form. This paragraph (e)(3) applies to discharges of indebtedness after December 31, 1994.

(4) *Direct or indirect subsidiary*. For purposes of section 6050P(c)(1)(C), the term direct or indirect subsidiary means a corporation in a chain of corporations beginning with an entity described in section 6050P(c)(1)(A), if at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of all classes of stock, of such corporation is directly owned by the entity described in section 6050P(c)(1)(A), or by one or more other corporations in the chain.

(5) *Use of magnetic media*. Any return required under this section must be filed on magnetic media to the extent required by section 6011(e) and the regulations thereunder. A failure to file on magnetic media when required constitutes a failure to file an information return under section 6721. Any person not required by section 6011(e) to file returns on magnetic media may request permission to do so under applicable regulations and revenue procedures.

(6) *TIN solicitation requirement*—(i) *In general*. For purposes of reporting under this section, a reasonable effort must be made to obtain the correct name/taxpayer identification number (TIN) combination of a person whose indebtedness is discharged. A TIN obtained at the time an indebtedness is incurred satisfies the requirement of this section, unless the entity required to file knows that such TIN is incorrect. If the TIN is not obtained prior to the occurrence of an identifiable event, it must be requested of the debtor for purposes of satisfying the requirement of this paragraph (e)(6).

(ii) *Manner of soliciting TIN*. Solicitations made in the manner described in §301.6724–1(e)(1)(i) and (2) of this chapter will be deemed to have satisfied the reasonable effort requirement set forth in paragraph (e)(6)(i) of this section. A TIN solicitation made after the occurrence of an identifiable event must clearly notify the debtor that the Internal Revenue Service requires the debtor to furnish its TIN, and that failure to furnish such TIN may subject the debtor to a $50 penalty imposed by the Internal Revenue Service. A TIN provided under this section is not required to be certified under penalties of perjury.

(7) *Recordkeeping requirements*. Any applicable financial entity required to file a return with the Internal Revenue Service under this section must also retain a copy of the return, or have the ability to reconstruct the data required to be included on the return under paragraph (a)(1) of this section, for at least four years from the date such return is required to be filed under paragraph (a)(4) of this section.

(8) *No multiple reporting*. If discharged indebtedness is reported under this section, no further reporting under this section is required for the amount so reported, notwithstanding that a subsequent identifiable event occurs with respect to the same amount. Further, no additional reporting or Form 1099–C correction is required if a creditor receives a payment of all or a portion of a discharged indebtedness reported under this section for a prior calendar year.

(f) *Requirement to furnish statement*—(1) *In general*. Any applicable financial entity required to file a return under this section must furnish to each person whose name is shown on such return a written statement that includes the following information—

(i) The information required by paragraph (a)(1) of this section;

(ii) The name, address, and TIN of the applicable financial entity required to file a return under paragraph (a) of this section;

(iii) A legend identifying the statement as important tax information that is being furnished to the Internal Revenue Service; and

(iv) Any other information required by Form 1099–C or its instructions, or current revenue procedures.

(2) *Furnishing copy of Form 1099–C*. The requirement to provide a statement to the debtor will be satisfied if the applicable financial entity furnishes copy B of the Form 1099–C or a substitute statement that complies with the requirements of the current revenue procedure for substitute Forms 1099.

(3) *Time and place for furnishing statement*. The statement required by this paragraph (f) must be furnished to the debtor on or before January 31 of the year following the calendar year in which the identifiable event occurs. The statement will be considered furnished to the debtor if it is mailed to the debtor's last known address.

(g) *Penalties*. For penalties for failure to comply with the requirements of this section, see sections 6721 through 6724.

(h) *Effective dates*—(1) *In general*. The rules in this section apply to discharges of indebtedness after December 21, 1996, except paragraphs (e)(1) and (e)(3) of this section, which apply to discharges of indebtedness after December 31, 1994.

(2) *Earlier application*. Notwithstanding the provisions of paragraph (h)(1) of this section, an applicable financial entity may, at its discretion, apply any of the provisions of this section to any discharge of indebtedness occurring on or after January 1, 1996, and before December 22, 1996.

§§1.6050P–0T and 1.6050P–1T [Removed]

Par. 3. Sections 1.6050P–0T and 1.6050P–1T are removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 5. In §602.101, paragraph (c) is amended by removing the entry for 1.6050P–1T and adding an entry in numerical order in the table to read ‘‘1.6050P–1 . . . . . 1545–1419’’.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 12, 1995.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 3, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 4, 1996, 61 F.R. 262)