**Q3. When is a debt deemed to be discharged and what is the significance of the issuance of a Form 1099-C to the taxpayer?**

Obviously, a debtor must report discharge of debt income in the year in which the creditor actually forgives the debt. However, in some instances, i.e., lack of communication between the creditor and the debtor, it may not be clear if and when a debt is actually forgiven. Therefore, in the absence of a formal discharge, it is possible that a creditor’s actions or inactions may result in a de facto discharge of the underlying debt. Moreover, absent imposing a reporting requirements on a creditor, debtors may be unlikely to voluntarily report discharge of debt income that could trigger a substantial tax liability.

Perhaps to address the uncertainty as to when a discharge of debt occurs, IRC Section 6050P generally requires financial institutions such as banks, credit unions and credit card companies to report discharge of debt. Specifically, pursuant to the regulations, upon the occurrence of an “identifiable event,” a creditor must issue a Form 1099-C (for discharges of at least $600 during the calendar year) whether or not an actual discharge has occurred on or before the date of the “identifiable event.”[[1]](#endnote-1) The list of the identifiable events includes:

* Discharge in bankruptcy;
* Cancellation that renders debt unenforceable in receivership, foreclosure or similar proceeding;
* Unenforceability due to the expiration of the statute of limitations for collection or expiration of statutory period for commencing deficiency judgment proceedings;
* Cancellation pursuant to a lender’s election to foreclose that statutorily extinguishes the lender’s right to pursue collection of the indebtedness;
* Cancellation or extinguishment of debt that renders it unenforceable pursuant to a probate or similar proceeding;
* Discharge pursuant to an agreement between a lender and debtor to discharge the debt for less than full consideration;
* Discharge pursuant to a lender’s decision or the application of defined policy of the lender to discontinue collection activity and discharge the debt; and
* In the case of certain creditor entities, the expiration of the non-payment testing period

In completing the Form 1099-C, entered in Box 6 is the identifiable event[[2]](#endnote-2) relied upon by the creditor in reporting the discharge of the debt.

**Q3A. Does the issuance of a Form 1099-C definitively establish discharge of debt income and/or the tax year in which it must be reported?**

No to both parts of the question. As to whether the issuance of a Form 1099-C definitively establishes discharge of debt income, the regulations state that the occurrence of an identifiable event is solely for the purpose of triggering the creditor’s reporting requirement.[[3]](#endnote-3) Additionally, the regulations make it clear that the discharged debt must be reported on Form 1099-C without regard to whether the debtor is required to include it in gross income.[[4]](#endnote-4) Therefore, in spite of receiving a Form 1099-C, the taxpayer may challenge whether the discharged debt is subject to tax.

*Example*: In 2015, Asher receives a Form 1099-C from a credit card company listing $100,000 of discharged debt. However, before and after the discharge, Asher is insolvent. Because of the insolvency exclusion (discussed in Q10B), none of the discharged debt would be includible in gross income. Therefore, on Form 982 attached to Form 1040, Asher would check line 1b (discharge of indebtedness to the extent of insolvency) for it to be excluded from gross income.

As to whether the issuance of Form 1099-C definitively establishes the year of discharge, case law indicates that the taxpayer may contest whether the identifiable event was correctly identified as well as whether it actually occurred in the year in which the Form 1099-C was issued.[[5]](#endnote-5)

*Example*: In 2000, Asher who was in default on credit card debt ceased making any payments. In 2004, the applicable statute of limitations for collection expired. Subsequently, in 2015, the credit card company issued a Form 1099-C to Asher reporting the discharge of the delinquent credit card balance (listing Code C in Box 6 -- statute of limitations or expiration of deficiency period as identifiable event). Since the statute of limitations expired in 2004, the Form 1099-C was issued in the wrong year. Thus, Asher may contest the inclusion of the discharge of debt income for tax year 2015.[[6]](#footnote-1)

**Q3B. Does the issuance of a Form 1099-C bar the creditor from pursuing subsequent collection against the debtor?**

Similar to income reported on any Form 1099 issued to the taxpayer, absent any exclusions (discussed in Q10, Q11 and Q12) or other legal defenses, the discharged debtor must include the amount of the forgiven debt listed on Form 1099-C (and pay the resulting tax) in the year in which it is issued. Under those circumstance, should the creditor who issued the Form 1099-C be barred from pursuing a collection action against the debtor? Obviously, if the creditor can pursue collection, it would seem to be unfair to the debtor who paid tax based on the amount of the reported discharged debt. Stated differently, should a Form 1099-C issued by a creditor be considered as a legally binding acknowledgement that the amount reported is in fact discharged for all purposes?

*Example*: In 2014, Asher who was in default on credit card debt ceased making any payments. The applicable statute of limitations for collection would not expire until 2017. In 2015, with no communication with Asher regarding the discharge of the credit card debt, the credit card company issues a Form 1099-C (Code G -- decision to discontinue collection). For the 2015 tax year, Asher reports the discharged credit card debt as income and pays the corresponding tax. Subsequently, in 2016, prior to the expiration of the limitation period, the credit card company sues Asher for nonpayment. Can Asher raise the 2015 issuance of the Form 1099-C as a defense?

As to whether the issuance of a Form 1099-C bars a creditor from pursuing collection, there is a split of authority. Although it may seem counterintuitive, according to the majority view, it does not bar the creditor from pursuing a legal collection action against the debtor.[[7]](#endnote-6) Conversely, relying on equitable principles of estoppel, the minority view bars the creditor issuing the Form 1099-C from subequently pursuing collection against the debtor.[[8]](#endnote-7)

**Q3C. What course of action is advised for a taxpayer who receives a Form 1099-C?**

Based on the discussion in Q3A and B, above, a taxpayer who receives a Form 1099-C has the following two concerns: (1) Has the debt been formally discharged by the creditor, and, if so, was it discharged in that year; and, (2) Is the discharge of debt taxable?

As to the first concern, based on the majority view discussed in Q3B, the taxpayer should contact the creditor to request formal confirmation of its discharge of the debt as well as the year of discharge. By securing a formal confirmation, the creditor would be barred from pursuing legal action against the taxpayer. If the creditor fails to provide the taxpayer with formal confirmation, the taxpayer should attempt to ascertain the validity of the identifiable event the creditor relied upon in issuing the Form 1099-C.

*Example*: In 2015, Asher received a Form 1099-C from a credit card company. In Box 6, Code G (decision or policy to discontinue collection) was entered. Although Asher requested a formal confirmation of the discharge in 2015, the credit card company failed to respond. Upon further review of his documentation, Asher ascertained the credit card debt was incurred in 2004 and the applicable statute of limitations for collection expired in 2007. Therefore, Code C (statute of limitations or expiration of deficiency period) was the proper identifiable event that should have been reported in 2007. Based on that information, Asher can challenge the inclusion of the discharged debt as income in 2015 as well as defend any subsequent collection action initiated by the credit card company.

As to the second concern, the receipt of a Form 1099-C reporting a substantial amount of discharged debt can be a daunting experience because of a large potential tax liability. As discussed in Q3, however, a Form 1099-C is simply a reporting requirement of the creditor and does not establish whether the amount reported is taxable to the debtor. For that reason, the taxpayer should consider the various exclusions (discussed in Q10 and Q12) that may apply to render all or part of the discharged debt non-taxable.

*Example*: In 2015, Asher received a Form 1099-C from a credit card company reporting a substantial amount of discharged debt. However, the debt reported on the Form 1099-C was discharged in bankruptcy. Because debt discharged in bankruptcy is excluded from gross income, Asher would not be taxed on such income. Attaching Form 982 to his 2015 Form 1040, Asher should check line 1a; and, thus exclude it from gross income.

1. 1.Treas. Reg. § 1.6050P-1(a)(1). [↑](#endnote-ref-1)
2. Each identifiable event is assigned a letter (A through I). [↑](#endnote-ref-2)
3. Treas. Reg. § 1.6050P-1(a)(1). [↑](#endnote-ref-3)
4. Treas. Reg. § 1.6050-1(a)(3) [↑](#endnote-ref-4)
5. See *Bacon v. Commissioner,* T.C. Summary Opinion 2015-15 (March 2, 2015). [↑](#endnote-ref-5)
6. *Bacon v. Commissioner,* T.C. Summary Opinion 2015-15 (March 2, 2015). [↑](#footnote-ref-1)
7. *Mennes v. Capital One, NA*, (W.D. Wisc. 2015); *FDIC v. Cashion*, 720 F. 3d 169 (4th Cir. 2013). [↑](#endnote-ref-6)
8. *In Re Reed*, 492 B.R. 261 (Barkr. E.D. Tenn. 2013); *In Re Crosby*, 261 B.R. 470 (Bankr, Kan. 2001). [↑](#endnote-ref-7)