DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

October 07, 2005

Number: **INFO 2005-0208**
Release Date: 12/30/05
UIL: 6050P.00-00

CC:PA:APJP:B01
GENIN-130393-05

Dear :

This letter responds to your request for information dated May 18, 2005, regarding the requirements under section 6050P of the Internal Revenue Code (Code) for reporting cancellation of indebtedness. Specifically, you request information concerning the reporting requirements under section 6050P(c)(2)(D) for organizations that purchase debt.

You state that your association's members are organizations that purchase debt for less than the face value of the debt. You also state that these organizations generally pursue collection activity on purchased debts until the collection activity is either prohibited by law or the period for reporting the debt to a credit reporting agency expires.

You state that an organization may purchase debt for a lump sum amount and may not know the breakdown of that amount into principal, interest, charges, and fees. Often these debts are settled for an amount less than the full amount owed. The typical settlement arrangement provides that the debtor will pay an amount equal to or approximating the principal balance due and that all interest, fees, and charges (to the extent these amounts can best be determined or estimated) will be discharged.

You requested clarification on the section 6050P reporting rules in the form of published guidance or a private letter ruling. The Internal Revenue Service (Service) has decided to address your inquiries in the form of an information letter rather than published guidance or a private letter ruling. Before issuing the final regulations under section 6050P(c)(2)(D) of the Code, the Service published a notice of proposed rulemaking in the Federal Register on June 13, 2002. See 67 F.R. 40629. The notice of proposed rulemaking contained a rule that, for purposes of section 6050P(c)(2)(D), "lending money" includes acquiring an indebtedness. See section 1.6050P-2(e) of the proposed regulations. The notice of proposed rulemaking provided the opportunity for public comment; the Service did not receive any comments from organizations that purchase debt on the rule in section 1.6050P-2(e) before issuing the final regulations. The

Service is not in a position to address your concerns in published guidance at this time. In addition, your request does not meet the requirements of a private letter ruling request set forth in Rev. Proc. 2005-1, 2005-1 I.R.B. 1.

Your inquiry poses several specific questions. We have grouped the questions and answers into the following categories.

Q1. Who is required to report a discharge of indebtedness under section 6050P of the Code and when does the requirement to report arise?

A1. Section 6050P(a) of the Code provides that any applicable entity that discharges indebtedness of any person during a calendar year must file an information return reporting the discharge. Section 6050P(b) provides that no information reporting is required under section 6050P(a) if the amount of the discharge is less than $600. Section 6050P(c)(2)(D) defines an "applicable entity" to include an organization with a significant trade or business of lending money.

Section 1.6050P-2(a) of the Income Tax Regulations (regulations) provides that lending money is a significant trade or business if the organization lends money on a regular and continuous basis during the calendar year. Section 1.6050P-2(e) provides that lending money includes acquiring an indebtedness. An organization that purchases debt may be an organization with a significant trade or business of lending money for purposes of section 6050P(c)(2)(D) of the Code and the regulations. The section 6050P(c)(2)(D) reporting requirements apply to discharges of indebtedness that occur on or after January 1, 2005. See section 1.6050P-2(i).

The reporting requirements of section 6050P of the Code and the regulations apply on a calendar year basis. Section 1.6050P-1 of the regulations provides that, upon the occurrence of an identifiable event during a calendar year, an applicable entity must report cancellation of indebtedness of $600 or more during the calendar year unless an exception to reporting applies. Section 1.6050P-1(b)(2)(i) provides eight identifiable events that trigger reporting of cancellation of indebtedness.

Q2. How does the 36-month non-payment testing period identifiable event apply to an organization that purchases debt, and how may the organization rebut the presumption that this identifiable event has occurred?

A2. Section 1.6050P-1(b)(2)(i)(H) of the regulations provides a rebuttable presumption that an identifiable event has occurred during a calendar year if a creditor has not received a payment during a 36 month testing period ending at the close of the year. In applying the non-payment testing period to an organization that purchases debt, on December 31 of each year, the organization must determine how long it has not received payment. See section 1.6050P-1(b)(2)(iv).

The section 6050P(c)(2)(D) reporting requirements apply to discharges of indebtedness that occur on or after January 1, 2005. See section 1.6050P-2(i). If the non-payment

testing period identifiable event, or any other identifiable event, occurred prior to the effective date of section 1.6050P-2, no reporting is required upon the occurrence of a subsequent identifiable event. If, however, an identifiable event has not occurred before the effective date of section 1.6050P-2, an organization must determine if an identifiable event, including the non-payment testing period identifiable event, has occurred during 2005 or during any subsequent year for purposes of section 6050P reporting.

An organization can rebut the presumption that the non-payment testing period identifiable event occurred by engaging in significant, bona fide collection activity during the last 12 months that is more than nominal or ministerial. See section 1.6050P-1(b)(2)(iv) of the regulations. This would require the organization to pursue collection activity beyond merely generating an automated mailing. See section 1.6050P-1(b)(2)(iv)(A). The organization can also rebut the presumption if the facts and circumstances on January 31 of the following year indicate the debt has not been discharged. See section 1.6050P-1(b)(2)(iv). The facts and circumstances may include the existence of a lien relating to the debt. See section 1.6050P-1(b)(2)(iv)(B).

Q3. How should an organization that purchases debt report discharges of indebtedness if it does not know the breakdown of an amount owed into principal, interest, charges, and fees?

A3. Section 1.6050P-1(c) of the regulations provides that an "indebtedness" means any amount owed and may include stated principal, fees, stated interest, penalties, administrative costs and fines. However, a discharge of interest is not required to be reported (see section 1.6050P-1(d)(2)), and only discharges of stated principal are required to be reported in the case of a lending transaction (see section 1.6050P-1(d)(3)).

Section 1.6050P-1(a)(1) of the regulations provides, in part, that an applicable entity must report the amount of the indebtedness discharged and any other information required by Form 1099-C, "Cancellation of Debt." The amount of the discharged debt is reported in Box 2. Any amount of interest that is included in Box 2 is separately reported in Box 3. Accordingly, to report properly, an applicable entity must separately report the amount of discharged interest in Box 3 if it included the discharged interest in the total amount reported in Box 2.

If an applicable entity does not know the breakdown of a purchased debt into principal, interest, charges, and fees, it should try to obtain this information so that it can determine the amount of interest and principal discharged. If, however, the entity cannot obtain this information, the entity should report using the best available information. See Q&A8 for discussion of waiver of penalties for failure to file correct information returns and furnish correct information statements.

Q4. If an organization that purchases debt discharges an amount owed that includes interest and principal, is the organization required to report only discharges of stated principal of $600 or more?

A4. Section 6050P(b) of the Code provides that no information reporting is required under section 6050P(a) if the amount of the discharge is less than $600. Section 1.6050P-1(a)(1) of the regulations provides that, except as provided in section 1.6050P-1(d), an applicable entity must report cancellation of indebtedness of $600 or more during a calendar year. Section 1.6050P-1(c) defines indebtedness to mean any amount owed to an applicable entity, including stated principal, fees, stated interest, penalties, administrative costs, and fines. Section 1.6050P-1(d)(3) provides that an applicable entity is not required to report amounts other than stated principal in lending transactions. Section 1.6050P-2(e) provides that lending money includes acquiring an indebtedness.

Although section 1.6050P-1(c) of the regulations provides a broad definition of what may constitute indebtedness for purposes of section 6050P of the Code, section 1.6050P-1(d)(3) provides that an applicable entity is required to report only stated principal in lending transactions. If an organization that purchases debt, which has a significant trade or business of lending money, discharges an amount owed that includes interest and principal, the organization is required to report only discharges of stated principal of $600 or more.

Q5. Does filing a Form 1099-C upon the occurrence of an identifiable event prohibit future collection activity on the amount reported?

A5. Section 1.6050P-1(a)(1) of the regulations provides that solely for purposes of the reporting requirements of section 6050P of the Code, a discharge of indebtedness is deemed to have occurred upon the occurrence of an identifiable event whether or not there is an actual discharge of indebtedness. Section 6050P and the regulations do not prohibit collection activity after a creditor reports by filing a Form 1099-C.

Q6. Is an organization that is required to report under section 6050P of the Code also required to notify a debtor that it will report a discharge of indebtedness prior to filing or that the discharge may be gross income?

A6. Section 6050P of the Code and the regulations do not require an applicable entity to notify a debtor that it will report a discharge of indebtedness prior to filing the Form 1099-C with the Service or that the discharge of indebtedness may be gross income. Section 6050P(d) provides, however, that an applicable entity required to file a return with the Service must also furnish a copy of the information return to the debtor.

Q7. Does section 6050P of the Code require collection attorneys, collection agencies, or organizations that purchase debt to notify a debtor of the tax consequences of a

discharge of indebtedness resulting from a settlement at less than the full amount owed?

A7. Section 6050P of the Code and the regulations do not require collection attorneys, collection agencies, or applicable entities to notify a debtor of the tax consequences of a discharge of indebtedness resulting from a settlement at less than the full amount owed.

Q8. Does section 6050P of the Code or the regulations provide a safe harbor to protect a creditor who informs a debtor that it will report cancellation of indebtedness from inadvertent violations of the Fair Debt Collections Practices Act, state consumer protection laws, the Federal Trade Commission Act, and state deceptive trade practices acts?

A8. Section 6050P of the Code and the regulations do not provide a safe harbor to protect a creditor who informs a debtor that it will report cancellation of indebtedness from inadvertent violations of the Fair Debt Collections Practices Act, state consumer protection laws, the Federal Trade Commission Act, and state deceptive trade practices acts. How the information reporting requirements of section 6050P impact other Federal or state consumer laws is beyond the scope of regulations under section 6050P.

Q9. What penalties may the Service impose for failure to report under section 6050P of the Code, and are there circumstances in which the Service may waive the penalties?

A9. Section 6721 of the Code provides a penalty for failure to file correct information returns with the Service. The Service may impose the penalty for: (1) a failure to file an information return before the due date, or (2) a failure to include all of the information required to be shown on the return or the inclusion of incorrect information. The penalty amount under section 6721 is generally $50 for each return with respect to which a failure occurs, not to exceed $250,000 per filer/per year. There are exceptions to the penalty and limitations to the maximum penalty amount that may be imposed if the filer corrects the failure within a specified time period, if the filer's failures to include information are de minimis, or if the filer's gross receipts do not exceed certain amounts. See section 6721(b)-(d). Section 6721(e) allows the Service to impose a higher penalty in the case of failures due to intentional disregard of filing requirements.

Section 6722 of the Code provides a penalty for a failure to furnish correct information statements. The Service may impose the penalty for: (1) failure to furnish an information statement on or before the due date, or (2) failure to include all of the information required to be shown on an information statement or the inclusion of incorrect information. The penalty amount under section 6722 is $50 per failure, not to exceed $100,000 per filer/per year. Section 6722(c) allows the Service to impose a higher penalty in the case of failures due to intentional disregard.

Pursuant to section 6724 of the Code and the regulations, the Service may waive penalties under section 6721 and section 6722 if the filer can demonstrate that the failure is due to reasonable cause and not to willful neglect. A filer may obtain a waiver of the penalty if it can establish that either: (1) there are significant mitigating factors with respect to the failure, as described in section 301.6724-1(b) of the Regulations on Procedure and Administration, or (2) the failure arose from events beyond the filer's control, as described in section 301.6724-1(c). In addition, the filer must demonstrate that it acted in a responsible manner, as described in section 301.6724-1(d), both before and after the failure occurred.

This letter calls your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Section 2.04 of Rev. Proc. 2005-1, 2005-1 I.R.B. 1. If you have any additional questions, please contact our office at .

Sincerely yours,

Donna Welch
Senior Counsel, Administrative Provisions &
Judicial Practice
(Procedure & Administration)