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

OFFICE OF
CHIEF COUNSEL

January 23, 2006

Number: **INFO 2006-0016**
Release Date: 3/31/06
UIL: 6050P.00-00, 6050P.01-00

CC:PA:APJP:B01
CONEX-162666-05

The Honorable Orrin G. Hatch
United States Senate
Washington, DC 20510

Dear Senator Hatch:

This letter responds to your inquiry to Commissioner Mark Everson, Internal Revenue Service, dated November 30, 2005, on behalf of organizations engaged in the business of buying and collecting outstanding delinquent debt. These organizations wrote to you about the information reporting requirements for cancellation of indebtedness under section 6050P of the Internal Revenue Code (the Code) and regulations.

Background

Any applicable entity, including an applicable financial entity, that discharges indebtedness of $600 or more of any person during a calendar year must file an information return with the Internal Revenue Service (IRS), and furnish an information statement to the debtor, showing the amount of discharged indebtedness [section 6050P of the Code]. In 1999 Congress expanded the definition of "applicable financial entity" to include any organization a significant trade or business of which is the lending of money by adding section 6050P(c)(2)(D). See Section 533(a) of the Tax Relief Extension Act of 1999, Public Law 107-170. Previously, an applicable financial entity included, in general, only banks, thrifts, and credit unions, their government-supervised subsidiaries, and certain government agencies (like the FDIC) that often succeed to the loan assets of failed financial institutions.

On June 13, 2002, the IRS and the Treasury Department issued proposed regulations under section 6050P(c)(2)(D) of the Code in section 1.6050P-2 of the Income Tax Regulations. See 67 F.R. 40,629. Section 1.6050P-2(e) of the proposed regulations stated:

> (e) *Acquisition of indebtedness by subsequent holder.* For purposes of this section, lending money includes acquiring an indebtedness, and gross income arising from such an acquired indebtedness is treated as gross income from lending money, without regard to whether the indebtedness was originated by either an applicable entity or a related party.

Consistent with IRS and Treasury Department practice, we provided a three-month notice-and-comment period, during which we received several comments. A hearing followed this period on October 8, 2002. We received additional communications that were made part of the record and were carefully considered in the preparation of the final regulations. We received no communications from the debt-buying/collecting industry at any time during the regulation process.

We issued the final regulations on October 25, 2004, more than two years after the hearing. See 69 F.R. 62,181. The definition in the final regulations that corresponds to the language quoted above reaches the same result as in the proposed regulations and articulates that result with even greater clarity:

> (e) *Acquisition of an indebtedness from a person other than the debtor included in lending money.* For purposes of this section, lending money includes acquiring an indebtedness not only from the debtor at origination but also from a prior holder of the indebtedness. Gross income arising from indebtedness is gross income from the lending of money without regard to who originated the indebtedness. If an organization acquires an indebtedness, the organization is required to report any cancellation of the indebtedness if the organization is engaged in a significant trade or business of lending money.

The regulations are effective for discharges of indebtedness occurring on or after January 1, 2005.

Meeting with Industry Representatives

At the industry's request, personnel from our Office of Chief Counsel met with representatives of the debt-buying/collecting industry on December 22, 2005. During this meeting, certain industry representatives requested a one-year delay in the applicability of the reporting requirements under section 6050P and the regulations to this industry. The representatives expressed two main concerns: (1) complying with the regulations might increase the threat of litigation under the Fair Debt Collection Practices Act (FDCPA), and (2) without the requested one-year delay, complying with the reporting requirements would be very difficult.

Threat of Litigation

The industry represents that typically a lender or debt-seller does not provide a breakdown of a delinquent debt into principal, interest, penalties, or other amounts, and the debt-buyer typically purchases the delinquent debt in a lump sum amount. As a result, an organization that buys debt may not be able to provide the most complete information on Form 1099-C, "Cancellation of Debt," and certain industry representatives believe that the debt-buying/collecting industry may face the threat of litigation under the FDCPA for providing false or misleading information. See 15 U.S.C. section 1692k.

In a lending transaction, an applicable entity is not required to report amounts other than stated principal [section 1.6050P-1d)(3) of the regulations]. The aggregate amount of cancelled debt

reported in Box 2 on Form 1099-C may include stated principal, fees, stated interest, penalties, or other amounts, but any amount of interest that is included in Box 2 should be separately reported in Box 3.

An organization that buys delinquent debt for a lump sum, however, may not know and cannot obtain the breakdown of the amount owed into principal, fees, interest, etc. In such a case, if the buyer cancels the debt, it might consider including, along with the Form 1099-C that is furnished to the debtor, a notification that the amounts reported on the Forms 1099-C are based on the best available information and that Box 2 may include interest that is not reported in Box 3 but that would have been so reported if more complete information had been available. We note that 15 U.S.C. section 1692k(c) of the FDCPA provides that a debt collector may not be held liable in any action if the debt collector shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.

One-Year Delay

As mentioned above, certain representatives of the debt-buying/collecting industry have requested a one-year delay in order to obtain more complete information from lenders or debt-sellers and to otherwise comply with the reporting requirements of section 6050P and the regulations. Although we continue to study how the pre–1999 rules and regulations under section 6050P should apply to applicable financial entities newly subject to reporting under section 6050P(c)(2)(D), we do not think it is appropriate to grant a one-year delay of the reporting requirement for the debt-buying/collecting industry.

Form 1099-C is a useful tool for the IRS in identifying taxpayers who may have income as a result of cancelled debt even without the breakdown between principal and interest, and the IRS might not otherwise be able to identify these taxpayers if we grant a delay of the reporting requirements. Moreover, in June 2002, the proposed regulations alerted the debt-buying/collecting industry that it might be subject to reporting responsibilities under section 6050P of the Code. The industry has had sufficient time since October 2004, when we published the final regulations, to prepare to comply with these requirements. We understand that some members of the industry knew about this reporting obligation and have taken steps to timely comply.

Granting blanket relief for noncompliance, regardless of whether an industry member had reasonable cause for failure to comply, might discourage and disadvantage those industry members who devoted the time and resources to fulfilling their reporting obligations. As noted above, some organizations that buy delinquent debt are ready to comply with the reporting requirements of section 6050P of the Code and the regulations at this time. Organizations that cannot fully comply at this time may, on a case-by-case basis, request under section 6724 and the regulations a waiver for reasonable cause of any penalties proposed under section 6721 (failure to file correct information returns) and section 6722 (failure to furnish correct information statements). A filer may establish reasonable cause if there are significant mitigating factors with respect to the failure (including that the filer was never previously

required to file the particular type of return or to furnish the particular type of statement), or if the failure arose from events beyond the filer's control [section 301.6724-1(a)(2) of the Regulations on Procedure and Administration]. In addition, a filer must show that it acted in a responsible manner both before and after the failure occurred. We are confident that this case-by-case process for reviewing requests for penalty relief will work better than a blanket waiver to provide relief to qualifying organizations without disadvantaging those organizations who have taken the steps to comply with their statutory and regulatory obligations.

I hope this information is helpful. If you have any additional questions, please contact either at or at of my office.

Sincerely,

Curtis G. Wilson
Assistant Chief Counsel, Administrative Provisions
& Judicial Practice
(Procedure & Administration)