Notice of Proposed Rulemaking and Notice of Public Hearing

Guidance Under Section 6050P Regarding Cancellation of Indebtedness

REG–107524–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the information reporting requirement under section 6050P of the Internal Revenue Code (Code) for cancellation of indebtedness. The proposed regulations reflect the enactment of section 6050P(c)(2)(D) by the Ticket to Work and Work Incentives Improvement Act of 1999. Section 6050P(c)(2)(D) requires organizations a significant trade or business of which is the lending of money to report discharges of indebtedness. The proposed regulations also conform the existing regulations to statutory changes made by the Debt Collection Improvement Act of 1996. In addition, under the proposed regulations, if an organization that is required to report under section 6050P (an applicable entity) forms, or avails itself of, some other entity for the principal purpose of holding loans acquired by the applicable entity, then, for purposes of section 6050P, the entity so formed or availed of is treated as having a significant trade or business of lending money. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 17, 2002. Requests to speak (with outlines of oral comments) at a public hearing scheduled for October 8, 2002, at 10:00 a.m., must be received by September 17, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–107524–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–107524–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at: *www.irs.gov/regs.* The public hearing will be held in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Donna J. Welch at (202) 622–4910;

concerning submissions and delivery of comments, and the hearing, Treena Garrett at (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) defining an organization a significant trade or business of which is the lending of money under section 6050P(c)(2)(D). Section 6050P(c)(2)(D) was enacted by section 553(a) of the Ticket to Work and Work Incentives Improvement Act of 1999, Public Law No. 106–170, 113 Stat. 1860, 1931 (1999) ("the Act"), effective for discharges of indebtedness occurring after December 31, 1999. Generally, section 6050P(a) requires organizations that are subject to that section (applicable entities) to file returns with the Service and to provide statements to persons whose names are required to be shown on the returns ("payees"), setting forth certain information regarding discharges of indebtedness of $600 or more. Section 553(a) of the Act amended section 6050P of the Code by expanding the types of entities that are required to report discharges of indebtedness to include any organization "a significant trade or business of which is the lending of money." Notice 2000–22, 2000–1 C.B. 902, provides that penalties under sections 6721 and 6722 will not be imposed on the lending organizations newly required to report discharges of indebtedness for failures to report discharges of indebtedness occurring before January 1, 2001. In addition, Notice 2001–8, 2001–1 C.B. 374, extended that suspension of penalties for failures to file information returns for any discharge of indebtedness that occurs prior to the first calendar year beginning at least two months after the date that appropriate guidance is issued.

This document also contains proposed amendments to the Income Tax Regulations (26 CFR part 1) conforming the existing regulations under section 6050P to statutory changes made by the Debt Collection Improvement Act of 1996.

Explanation of Provisions

Under section 6050P(c)(2)(D), any organization "a significant trade or business of which is the lending of money" is required to report discharges of indebtedness. These proposed regulations provide guidance on when a trade or business is the lending of money and when that trade or business is significant. In general, the proposed regulations provide that the lending of money is a significant trade or business if money is lent on a regular and continuing basis. The regulations provide three safe harbors under which organizations will not be considered to have a significant trade or business of lending money. The IRS and the Treasury Department believe that these safe harbors satisfy the information reporting objectives of the statute while minimizing the administrative burden on taxpayers.

The first safe harbor applies to organizations that were not required to report under section 6050P in the previous calendar year. Such an organization will be considered not to have a significant trade or business of lending money for the calendar year if its gross income from lending money in the most recent test year (the most recent taxable year ending before July 1 of the previous calendar year) is less than both 15 percent of the organization's gross income and $5 million.

The second safe harbor applies to organizations that were required to report under section 6050P for the previous calendar year. Such an organization will be considered not to have a significant trade or business of lending money for the calendar year if, for each of the three most recent test years, its gross income from lending money is less than both 10 percent of the organization's gross income and $3 million. The IRS and the Treasury Department believe that a stricter safe harbor is appropriate for taxpayers that have been subject to section 6050P in a prior year and, therefore, presumably have systems in place to comply with the information reporting requirements of the statute.

The third safe harbor applies to certain newly formed organizations. Except for an entity that is formed or availed of for the principal purpose of holding loans acquired by an applicable entity (as defined in section 6050P), an organization that does not have a test year is considered not to have a significant trade or business of lending money even if the organization lends money on a regular and continuing basis. This safe harbor and the use of a "test year" in determining whether a taxpayer fits within the other safe harbors provides taxpayers with some advance notice (*i.e.*, at least six months) of whether they will need to establish systems to track and report discharges of indebtedness.

In addition to the safe harbors discussed above, the proposed regulations provide a general exception to information reporting for entities whose principal trade or business is the sale of nonfinancial goods or the provision of nonfinancial services. Such entities are not considered to have a significant trade or business of lending money with respect to lending or credit extended in connection with the purchase by customers of those goods and services. This is consistent with the legislative history, which indicates that, in amending section 6050P, Congress was concerned with credit card and finance companies. S. Rpt. No. 201, 106th Cong., 1st Sess. 28 (1999). The IRS and the Treasury Department believe that Congress did not mean to extend the reporting requirement to retailers and other entities who extend credit to customers in connection with the purchase of nonfinancial goods and services. However, consistent with applying the tests under section 6050P on an entity-by-entity basis, this exception is not available to a separate financing subsidiary of such a retailer. In addition, if such a retailer is subject to section 6050P regardless of its accounts receivable, it is required to report discharges of indebtedness of accounts receivable as well as other debt.

The proposed regulations also provide that, for purposes of section 6050P(c)(2)(D), lending money includes acquiring a loan, and gross income arising from that loan is gross income from lending money. Therefore, an organization that buys and holds loans is treated as an organization that lends money. This is consistent with the temporary regulations under section 6050J (relating to information returns for acquisitions and

abandonments of property that is security for indebtedness). See § 1.6050J–1T, Q&A–22.

Finally, the proposed regulations amend § 1.6050P–1 to provide a new rule applicable to all entities subject to section 6050P, not just those newly made subject to section 6050P by the 1999 amendment. The current regulations under section 6050P (§ 1.6050P–1(e)(2)) contain rules respecting the reporting requirements of debtors when indebtedness is owned by more than one creditor. Each creditor that is an applicable entity is required to report with respect to any discharge of indebtedness of $600 or more allocable to that creditor. For purposes of this rule, indebtedness owned by a partnership is treated as owned by the partners, with the result that reporting may be required of the partners with respect to a cancellation of debt held by the partnership. Rules respecting compliance with this pass-through reporting requirement by holders of interests in certain pass-through securitized indebtedness arrangements and REMICs were reserved. § 1.6050P–1(e)(2)(iii) & (iv). The preamble to those regulations states that penalties will not be imposed for nonreporting by holders of interests in these entities.

Conceivably, an entity that otherwise would be required to report under section 6050P with respect to its debt (for example, an entity that regularly and continuously lends money and does not meet the safe harbors of these proposed regulations), could transfer debt that it originates to a special purpose subsidiary or trust in a single transaction. Through this structure, the originator could possibly avoid application of section 6050P by arguing that the reservation of rules in the regulations for pass-through securitized indebtedness arrangements absolves them of any reporting obligation and that the transferee entity does not meet the requirements of regular and continuous lending activity.

To address the foregoing concern, the amendment to § 1.6050P–1 by the proposed regulations provides that an entity formed or availed of by an applicable entity for the principal purpose of holding loans acquired or originated by the applicable entity is treated as having a significant trade or business of lending money. Accordingly, the transferee entity itself is treated as an applicable entity for purposes of section 6050P(c)(2)(D). If the entity formed or availed of by the applicable entity is a REMIC or a pass-through securitized indebtedness arrangement as defined in § 1.6050P–1(e)(2)(iii)(B), the REMIC or pass-through securitized indebtedness arrangement will be treated as an applicable entity for purposes of section 6050P(c)(2)(D), despite the reservation in § 1.6050P–1(e)(2)(iii) and (iv) of the application of section 6050P to holders of interests in REMICs and pass-through securitized indebtedness arrangements.

Proposed Effective Date

The regulations, as proposed, apply to any discharge of indebtedness occurring in any calendar year beginning at least two months after the date that the final regulations are published in the **Federal Register**. Regardless of when the final regulations are made effective, the rules in these proposed regulations may be relied on for prior taxable periods.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. The information collection referenced in this proposed rule (Form 1099–C) has been previously reviewed and approved by the **Office of Management and Budget** under OMB Control Number 1545–1424. An agency may not collect or sponsor the collection of information unless it displays a valid OMB Control Number. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 8, 2002, beginning at 10 a.m. in Room 4718 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors must enter at the main entrance, located at 1111 Constitution Avenue, NW. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit electronic or written comments and an outline of the topic to be discussed and time to be devoted to each topic (preferably a signed original and eight (8) copies) by September 17, 2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Sharon L. Hall, Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendment to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

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

Section 1.6050P–1 and 1.6050P–2 also issued under 26 U.S.C. 6050P. * * *

Par. 2. Section 1.6050P–0 is amended as follows:

1. The introductory text is amended by adding the language "and § 1.6050P–2" immediately after the language "§ 1.6050P–1".

2. The heading for § 1.6050P–1 is amended by removing the word "financial".

3. The entry for § 1.6050P–1(e)(2)(v) is added.

4. The entries for §§ 1.6050P–1(e)(5) through (e)(8) are redesignated as entries for §§ 1.6050P–1(e)(6) through (e)(9) and a new entry for § 1.6050P–1(e)(5) is added.

5. The entries for § 1.6050P–2 are added.

The additions read as follows:

§ 1.6050P–0 Table of Contents.

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

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(e)***

(2)***

(v) No double reporting.

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(5) Entity formed or availed of to hold indebtedness.

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§ 1.6050P–2 Organizations a significant trade or business of which is the lending of money.

(a) In general.

(b) Safe harbors.

(1) Organizations not subject to section 6050P in the previous calendar year.

(2) Safe harbor for organizations that were subject to section 6050P in the previous calendar year.

(3) No test year.

(c) Seller financing.

(d) Gross income from lending of money.

(e) Acquisition of indebtedness by subsequent holder.

(f) Test year.

(g) Predecessor organization.

(h) Examples.

(i) Effective date.

Par. 3. Section 1.6050P–1 is amended as follows:

1. The heading for § 1.6050P–1 is amended by removing the word "financial".

2. Paragraphs (a)(1), (b)(2)(i)(F), (c), (e)(2)(i), (e)(3), (e)(7), (f)(1) introductory text, (f)(1)(ii) and (f)(2) are amended by removing the word "financial".

3. The first sentence of paragraph (c) is amended by adding "and section 1.6050P–2" immediately after the word "section".

4. Paragraph (e)(2)(v) is added.

5. Paragraph (e)(4) is amended by removing "6050P(c)(1)(A)" each time it appears and adding "6050P(c)(2)(A)" in its place and by removing "6050P(c)(1)(C)" and adding "6050P(c)(2)(C)" in its place.

6. Paragraphs(e)(5) through (e)(8) are redesignated as (e)(6) through (e)(9) and a new paragraph (e)(5) is added.

7. Paragraph (e)(7)(i), as redesignated, is amended by removing "(e)(6)" where it appears and adding "(e)(7)" and paragraph (e)(7)(ii), as redesignated, is amended by removing "(e)(6)(i)" where it appears and adding "(e)(7)(i)" in its place.

8. Paragraph (h)(1) is amended by adding "and, except paragraph (e)(5) of this section, which applies to discharges of indebtedness occurring in any calendar year beginning at least two months after the date that the final regulations are published in the **Federal Register.**", immediately after the language "1994".

The additions read as follows:

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

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(e)***

(2)***

(v) *No double reporting*. If multiple creditors are considered to hold interests in an indebtedness under paragraph (e)(2) of this section, and an entity is required to report a discharge of that indebtedness under paragraph (e)(5) of this section, then such multiple creditors are not required to report the discharge of indebtedness.

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(5) *Entity formed or availed of to hold indebtedness*. Notwithstanding § 1. 6050P–2(b)(3), if an entity (the transferee entity) is formed or availed of by an applicable entity (within the meaning of section 6050P(c)(1)) for the principal purpose of holding indebtedness acquired (including originated) by the applicable entity, then, for purposes of section 6050P(c)(2)(D), the transferee entity has a significant trade or business of lending money.

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Par. 4. A new § 1.6050P–2 is added as follows:

§ 1.6050P–2 Organization a significant trade or business of which is the lending of money.

(a) *In general*. For purposes of section 6050P(c)(2)(D), the lending of money is a significant trade or business of an organization in a calendar year if the organization lends money on a regular and continuing basis during the calendar year.

(b) *Safe harbors*—(1) *Organizations not subject to section 6050P in the previous calendar year*. For an organization that was not required to report under section 6050P in the previous calendar year, the lending of money will not be treated as a significant trade or business for the calendar year in which the lending occurs if gross income from lending money in the organization's most recent test year (as defined in paragraph (f) of this section) is both less than $5 million and less than 15 percent of the organization's gross income for that test year.

(2) *Organizations that were subject to section 6050P in the previous calendar year*. For an organization that was required to report under section 6050P for the previous calendar year, the lending of money will not be treated as a significant trade or business for the calendar year in which the lending occurs if gross income

from lending money in each of the organization's three most recent test years is both less than $3 million and less than 10 percent of the organization's gross income for that test year.

(3) *No test year*. The lending of money will not be treated as a significant trade or business for an organization for the calendar year in which the lending occurs if the organization does not have a test year for that calendar year.

(c) *Seller financing*. If the principal trade or business of an organization is selling nonfinancial goods or providing nonfinancial services and if the organization extends credit to the purchasers of those goods or services in order to finance the purchases, then, for purposes of section 6050P(c)(2)(D), these extensions of credit are not a significant trade or business of lending money.

(d) *Gross income from lending of money*. For purposes of this section, gross income from lending of money includes income from interest, fees, penalties, merchant discount, interchange and gains arising from the sale of an indebtedness.

(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.

(f) *Test year*. For any calendar year, a *test year* is a taxable year of the organization that ends before July 1 of the previous calendar year.

(g) *Predecessor organization*. If an organization acquires substantially all of the property that was used in a trade or business of some other organization (the predecessor) (including when two or more corporations are parties to a merger agreement under which the surviving corporation becomes the owner of all the assets and assumes all the liabilities of the absorbed corporations(s)) or was used in a separate unit of the predecessor, then whether the organization at issue qualifies for one of the safe harbors in paragraph (b) of this section is determined by also taking into account the test years, reporting obligations, and gross income of the predecessor.

(h) *Examples*. The rules of this section are illustrated by the following examples.

Example 1. Finance Company A, a calendar year taxpayer, was formed in Year 1 as a non-bank subsidiary of Manufacturing Company and has no predecessor. A lends money to purchasers of Manufacturing Company's products on a regular and continuing basis to finance the purchase of those products. A's gross income from interest in Year 1 is $4.7 million. A's gross income from fees and penalties related to the lending activity in Year 1 is $.5 million. Section 6050P does not require A to report discharges of indebtedness occurring in Years 1 or 2, because A has no test year for those years. Notwithstanding that A lends money in those years on a regular and continuing basis, under paragraph (b)(3) of this section, A does not have a significant trade or business of lending money in those years for purposes of section 6050P(c)(2)(D). However, for Year 3, A's test year is Year 1. A's gross income from lending in Year 1 is not less than $5 million for purposes of the applicable safe harbor of paragraph (b)(1) of this section. Because A lends money on a regular and continuing basis and does not meet the applicable safe harbor, section 6050P requires A to report discharges of indebtedness occurring in Year 3.

Example 2. The facts are the same as in *Example 1*, except that A is a division of Manufacturing Company, rather than a separate subsidiary. Manufacturing Company's principal activity is the manufacture and sale of non-financial products, and other than financing the purchase of those products Manufacturing Company does not extend credit or otherwise lend money. Accordingly, under paragraph (c) of this section, that financing activity is not a significant trade or business of lending money for purposes of section 6050P(c)(2)(D), and section 6050P does not require Manufacturing Company to report discharges of indebtedness.

Example 3. Company B, a calendar year taxpayer, is formed in Year 1. B has no predecessor and a part of its activities consists of the lending of money. B packages and sells part of the indebtedness it originates and holds the remainder. B is engaged in these activities on a regular and continuing basis. For Year 1, B's gross income from sales of the indebtedness, combined with interest income, fees, and penalties related to the lending activity is only $4.8 million, but it is 16% of B's gross income in Year 1. Because B lends money on a regular and continuing basis and does not meet the applicable safe harbor of paragraph (b)(1) of this section, section 6050P requires B to report discharges of indebtedness occurring in Year 3. B is not required to report discharges of indebtedness in years 1 and 2 because B has no test year for years 1 and 2.

Example 4. The facts are the same as in *Example 3*. In addition, in each of Years 2, 3, and 4, B's gross income from sales of the indebtedness combined with interest income, fees, and penalties related to the lending activity is less than both $3 million and 10% of B's gross income. Because B was required to report under section 6050P for Year 3, the applicable safe harbor for Year 4 is paragraph (b)(2) of this section, which is satisfied only if B's gross income from lending activities for each of the three most recent test years is less than both $3 million and 10% of B's gross income. For Year 4, even though B has only two test years, B's gross income in one of those test years, Year 1, causes B to fail to meet this safe harbor. Accordingly, B is required to report discharges of indebtedness under section 6050P in Year 4. For Year 5, B's three most recent test years are Years 1, 2, and 3. However, B's gross income from lending activities in Year 1 is not less than $3 million and 10% of B's gross income. Accordingly, section 6050P requires B to report discharges of indebtedness in Year 5. For Year 6, B satisfies the applicable safe harbor requirements of paragraph (b)(2) for each of the three most recent test years (Years 2, 3, and 4). Therefore, section 6050P does not require B to report discharges of indebtedness in Year 6. Because B is not required to report for Year 6, the applicable safe harbor for Year 7 is the one contained in paragraph (b)(1) of this section, and thus the only relevant test year is year 5.

(i) *Effective date*. This section is effective for discharges of indebtedness occurring in any calendar year beginning at least two months after the date that the final regulations are published in the **Federal Register.**

Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

(Filed by the Office of the Federal Register on June 12, 2002, 8:45 a.m., and published in the issue of the Federal Register for June 13, 2002, 67 F.R. 40629)