
Surprise! When A Lender Sends A Debtor A Form 1099-C Cancellation Of Debt, It Doesn't Necessarily Mean That The Debt Has Been Cancelled

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The Internal Revenue Code requires a lender to file a Form 1099-C entitled "Cancellation of Debt" for the purpose of tax reporting any time the lender discharges \$600 or more of indebtedness of a debtor during any calendar year. This reporting requirement is triggered when one of the "identifiable events" listed in the regulations has occurred. The identifiable events include:

- Discharge of indebtedness under the Bankruptcy Code;
- Cancellation of indebtedness that renders the debt unenforceable in receivership, foreclosure, or similar proceeding;
- Unenforceability of indebtedness upon the expiration of the statute of limitations for collection or upon the expiration of a statutory period for commencing a deficiency judgment proceeding;
- Cancellation of an indebtedness pursuant to the lender's election of foreclosure remedies that statutorily extinguish the lender's right to pursue collection of the indebtedness;
- Discharge of indebtedness pursuant to an agreement between the lender and a debtor to discharge indebtedness at less than full consideration; and,
- Discharge of indebtedness pursuant to a decision by the lender, or the application of a defined policy of the lender, to discontinue collection activity and discharge the debt.

The requirement that a Form 1099-C be filed in the listed situations has caused much confusion for debtors who assume that their obligation to repay the debt has been terminated by the lender's "cancellation," especially when the debtor has to pay taxes for the amount of the cancelled debt which the IRS treats as income.

The courts have not been consistent in their rulings on the effect of filing a Form 1099-C on the continued validity and enforceability of the "cancelled" debt.

A minority of courts have ruled that the filing of a Form 1099-C can result in dismissal of a lender's subsequent collection action for the debt and in the actual discharge of the indebtedness. A recent United States Bankruptcy Court decision in Tennessee concluded that while the issuance of a Form 1099-C does not, as a matter of law, operate to extinguish the indebtedness, it does "reflect" that the lender has discharged or cancelled the debt. The Bankruptcy Court concluded that the lender could not pursue a deficiency claim for the amount included in the filed Form 1099-C.

Nevertheless, the majority of courts, including the United States Court of Appeals for the Fourth Circuit (which has jurisdiction over all federal cases, including bankruptcy cases, arising in North Carolina), have held that the mere filing of a Form 1099-C does not discharge the debtor from liability for the debt. In a 2013 decision, the Fourth Circuit reasoned that a lender may be required to file a Form 1099-C even where the lender has not actually given up on collection of the debt and cancelled it. Therefore, the Court held that the mere fact that a Form 1099-C is filed does not constitute sufficient evidence, standing alone, that the debt has been

cancelled. The Fourth Circuit stated that "filing a Form 1099-C is a creditor's required means of satisfying a reporting obligation to the IRS; it is not a means of accomplishing an actual discharge of debt." The Court then ruled that, as a matter of law, a jury cannot render a verdict in a debtor's favor that a debt was cancelled or assigned when the sole evidence put forth by the debtor is the lender's filing of a Form 1099-C.

Under the Fourth Circuit's ruling, the filing of a Form 1099-C is not evidence that a lender has actually cancelled a debt, but rather is, at most, an indication by the lender of an intention to cancel the debt in the future. Thus, a lender may subsequently attempt to collect the debt even after it has filed a Form 1099-C with respect to it.

However, the Fourth Circuit's ruling may not, and probably will not, stop debtors from asserting cancellation as a defense to collection actions after their receipt of a Form 1099-C. Although lenders are not required to identify a reason for filing a Form 1099-C, in order to avoid facing debtor defenses in litigation claiming that the Form 1099-C filing was evidence of a cancellation, lenders may want to consider sending correspondence to the debtor along with the Form 1099-C indicating the reason why the lender is required to file the Form 1099-C and clearly stating that the debt may still be subject to future collection efforts by the lender.

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