

# IRS Repeals 36-Month Rule for Reporting Discharges of Indebtedness

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The Internal Revenue Service (“IRS”) has removed the 36-month nonpayment testing period from the list of “identifiable events” for determining when the debt had been discharged for purposes of issuing Form 1099-C to taxpayers. This change is effective for Form 1099-Cs due after December 31, 2016. Accordingly, for purposes of filing a Form 1099-C for the 2016 calendar year, financial institutions should no longer apply the 36-month nonpayment testing period when determining if a Form 1099-C must be filed.

Section 6050P of the Internal Revenue Code (“IRC”) requires a creditor (such term includes a financial institution) to report a discharge of debt on Form 1099-C when an “identifiable event” has occurred. IRS regulations had set forth eight identifiable events: (i) a discharge of indebtedness under Title 11 of the U.S. Code (i.e., a bankruptcy), (ii) a cancellation or extinguishment of an indebtedness that renders a debt unenforceable in a receivership, foreclosure, or similar proceeding, (iii) a cancellation or extinguishment of an indebtedness upon the expiration of the statute of limitations for collection or upon the expiration of a statutory period for filing a claim or commencing a deficiency judgment proceeding, (iv) a cancellation or extinguishment of an indebtedness pursuant to an election of foreclosure remedies by a creditor that statutorily extinguishes or bars the creditor’s right to pursue collection, (v) a cancellation or extinguishment of an indebtedness that renders a debt unenforceable pursuant to a probate or similar proceeding, (vi) a discharge of indebtedness pursuant to an agreement between the financial institution and a debtor to discharge the debt at less than full consideration, (vii) a discharge of indebtedness pursuant to a decision by the creditor or the application of a defined policy of the creditor to discontinue collection activity and discharge debt, or (viii) the expiration of the 36-month nonpayment testing period.

The first seven of the identifiable events are specific instances that actually result in a discharge of debt. The eighth identifiable event, the 36-month nonpayment testing period, may not result from an actual discharge of indebtedness. Rather, it creates a rebuttable presumption that an identifiable event has occurred if a creditor does not receive a payment within the testing period. This presumption can be rebutted if the creditor has engaged in “bona fide collection activity” during the calendar year or if facts and circumstances existing as of January 31 following the expiration of the nonpayment testing period indicate that the indebtedness has not been discharged.

Although creditors were required to file a Form 1099-C at the end of the 36-month period, it did not mean that the debt had necessarily been canceled. As a result, taxpayers who had received such form were often confused

about whether receipt of a Form 1099-C represented cancellation of indebtedness that must be included in gross income. In addition, the Treasury Department and IRS have found that the 36-month nonpayment testing period did not increase tax compliance or provide the IRS with valuable third-party information that may be used to ensure taxpayer compliance. Therefore, in October 2014, the IRS proposed a rule which completely removed the 36-month rule from the list of identifiable events.

The proposed regulation has now been adopted as final, with a minor change made to the applicability date of the final regulation. The final regulation removing the 36-month rule is applicable to information returns required to be filed and payee statements required to be furnished after December 31, 2016. Therefore, for purposes of filing a Form 1099-C for the 2016 calendar year, financial institutions will no longer need to apply the 36-month rule when determining if a Form 1099-C must be filed. The seven other identifiable events requiring a financial institution to file a Form 1099-C are still in effect and have remained unchanged.

If you have any questions regarding this advisory or the filing of a Form 1099-C in general, please feel free to contact Joseph D. Simon at [516-357-3710](tel:516-357-3710) or via email at [jsimon@cullenanddykman.com](mailto:jsimon@cullenanddykman.com) or Elizabeth A. Murphy at [516-296-9154](tel:516-296-9154) or via email at [emurphy@cullenanddykman.com](mailto:emurphy@cullenanddykman.com).

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- Joseph D. Simon