

Apple Federal Credit Union

Reporting Delinquent Matters and 1099-A and 1099-C Presentation 2014

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Reporting Delinquent Matters

- NCUA guidelines regarding the information Credit Unions furnish to consumer reporting agencies about consumers relates to the “accuracy” and “integrity” of the information reported.
- However, in the event the Credit Union chooses to continue to manage all bad debt in its database, for so long as the debt remains due, and maintains all bad debt accounts in the same manner, such action is permissible.
- There is no legal requirement that a Credit Union remove bad debt from its books or records, as long as all bad debt of all members and former members are treated in the same manner and the information stored and reported is updated and accurate.
- Section 605 of the FCRA dictates the terms under which consumer reporting agencies may report information relating to consumers.
- The obligation to accurately report information provided by creditors, as outlined in § 605 of the FCRA, as well as to remove or correct items, as outlined in § 605 of the FCRA, is the responsibility of the consumer reporting agencies.
- There is no requirement that the creditor remove the accurate debtor information from its reports to the consumer reporting agencies, nor is there a requirement to cease collection activities if it so chooses to pursue the debtor.
- Bad debt remains bad debt until paid (bad debt may remain on the Credit Union’s books so long as the Credit Union is following developed guidelines and regulations established for bad debt reporting).
- FCRA rules regarding consumer credit reporting and timing as to the removal of aged accounts are rules that govern the consumer reporting agencies, not the Credit Union.

1099 Overview

Highlights:

- The law requires a lender to “File Form 1099-A Acquisition or Abandonment of Secured Property, for each borrower if you lend money in connection with your trade or business and, in full or partial satisfaction of the debt, you acquire an interest in property that is security for the debt, or you have reason to know that the property has been abandoned. You need not be in the business of lending money to be subject to this reporting requirement.”
- 26 CFR 1.6050P-1, which corresponds to 26 USC § 6050P identifies eight (8) “Events” that require a creditor to file a Form 1099-C, which classify a debt as cancelled, either actually or strictly for reporting purposes whether the creditor intends to discharge the debtor or not. Seven of the events – bankruptcy, other judicial relief, statute of limitations or expiration of deficiency period, foreclosure election, debt relief from probate or similar proceeding, by agreement, decision or policy to discontinue collection, and other actual discharge before identifiable event – are often the result of an actual discharge or cancellation of debt and preclude a creditor from continuing collection efforts.
- The eighth event is described as the “Expiration of nonpayment testing period.” “The testing period is a 36-month period, [during which] the creditor has not received a payment on the debt. . .”
- Creditors must file 1099-C at any time debt is discharged, but also must do so when any of the above referenced “events” occur whether actual discharge is intended or not.

Practical Tips

- IRS form 1099 is used by various lending entities to report income that they have perceived a third party has earned. For example, a Credit Union issues a credit card, makes an unsecured loan, makes a secured or unsecured auto loan, or mortgage loan, and the amounts due and owing are never paid. After some time, and a referenced test is met, the Credit Union should issue the member a 1099.

1099-A Best Practices

Highlights:

- On Form 1099-A, the credit union reports the amount of the debt owed (principal only) and the fair market value of the secured property. The member, must then use these values to determine a gain or loss on the disposition of the property.
- A 1099-A does not mean a debt was canceled, only that a property has been foreclosed or repossessed or abandoned. Box 2 of 1099-A will show the outstanding loan balance, and Box 4 shows the fair market value at the time of foreclosure. One of these figures will determine any tax liability.
- Form 1099-A is used to report that property was abandoned by the member or subject to foreclosure proceeding. It does not refer to whether or not the debt was cancelled.
- A 1099-A is a neutral document it is not a cancellation of debt but rather it is a notice document to the member.

Practical Tips

- Issue a 1099-A on abandoned real or personal property.
- For example in the case of a foreclosure, because the "sale" is involuntary, a 1099-A (Acquisition or Abandonment of Secured Property) is issued to report the transfer of the property.
- The 1099-A reports the date of the transfer, the fair market value on the date of the transfer and the balance of principal outstanding on the date of the transfer.
- Just like the 1099-S, the 1099-A is used to determine whether there is a gain or loss on the sale of the property.
- IRS Code requires the filing of a 1099-C, not a 1099-A, in the event a debt is determined to be uncollectable or in the event the member files for bankruptcy protection.
- A 1099-A must be sent to the member at their last know address (preferably via certified mail, return receipt requested).

1099-C Best Practices

Highlights:

- Form 1099-C indicates the cancellation of debt, typically after a foreclosure, a discharge in bankruptcy or the discharge and write-off of a debt.
- A 1099-C can be issued on an unpaid debt for the entire balance that is due at the time of issuing the 1099-C or for the cancelled portion of the debt when a debt settlement has been agreed to.
- The Credit Union may issue a 1099-C for the balance due on second mortgage write downs, settlements of unsecured or secured claims or "cram downs" where any or all of the principal balance due to the Credit Union remains unpaid.
- Once the Credit Union issues a 1099-C, the member is required to report this unpaid debt as income on their tax returns.
- Exclusions can be used to reduce or eliminate the cancellation of debt income from taxable income. These include discharge of the debt in bankruptcy, insolvency of the seller before the creditor agreed to forgive or cancel the debt, or, if the seller qualifies, relief pursuant to the Mortgage Forgiveness Debt Relief Act (MFDRA).

Practical Tips:

- Issue a 1099-C on upon the cancellation of debt typically when a IRS "test" is met.
- As an example, in the event of a discharge in bankruptcy or if a unsecured debt is not paid and charged-off a 1099-C should be issued to report the cancellation of the debt.
- As an example, in secured debt involving a real property short sales where the member's debt is not paid in full, a 1099-C should be issued to report the cancellation of debt resulting from a short sale or deed in lieu of foreclosure.
- A 1099-C must be sent to the member at their last know address (preferably via certified mail, return receipt requested).
- As exemptions do exist, members may avoid paying taxes once a Credit Union issues a 1099-C.

IRS Position on 1099-C

Highlights:

- “The Internal Revenue Service does not view a Form 1099-C as an admission by the creditor that it has discharged the debt and can no longer pursue collection.”
 - See IRS Info Ltr. 2005-0207 and IRS Info Ltr. 2005-0208

“Section 1.6050P-1(a) of the regulations provides that, solely for purposes of reporting cancellation of indebtedness, a discharge of indebtedness is deemed to occur when an identifiable event occurs whether or not an actual discharge of indebtedness has occurred on or before the date of the identifiable event.”

- The Identifiable Events triggering the issuance of a 1099-C
 - (1) bankruptcy; (2) expiration of statute of limitations for collection; (3) cancellation of debt that renders it unenforceable in a receivership, foreclosure, or similar proceeding; (4) creditor's election of foreclosure remedies that statutorily bars recovery; (5) cancellation of debt due to probate proceedings; (6) creditor's discharge pursuant to an agreement; (7) 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; and (8) in specific cases, the expiration of a non-payment testing period [presumption of 36 months of no payment to creditor] [\$600 or more]

Practical Tips:

- The filing of a 1099-C should be filed when the above noted “Identifiable Events” test is met.
- Current case law suggests collection efforts may continue, but it is advised Credit Unions proceed with caution if collection efforts are continued.

Bankruptcy and 1099 Filings – Majority Court Opinion

Highlights:

- There is currently a split in authorities as to whether the issuance of a 1099-C by the lender prohibits collection of a debt reported in a Form 1099-C
- The traditional and current majority view is that the issuance of the 1099-C does not discharge the debt and the lender may continue collections. If collections continue after the issuance of the 1099-C, then an amended 1099-C must be filed to grant tax relief to the debtor. This view respects the IRS' interpretation that the issuance of a 1099-C is strictly a reporting requirement for tax purposes and cannot be construed to also constitute a present release of rights against a debtor. See *In re Zilka* 407 B.R. 684 (Western District of PA 2009)

Practical Tips:

- Base your 1099-C issuance policy on the IRS' "Identifiable Events" and timely issue the 1099-C Forms
- Expressly state that the 1099-C is issued for the purpose of complying with the IRS regulations and not for the purpose of discharging the debt owed by the defaulted borrower

Bankruptcy and 1099 Filings – Minority Court Opinion

The most recent but current minority view of the Bankruptcy Courts is from the case of *In re Reed* 492 B.R. 261 (Eastern District of Tennessee 2013).

- Specifically in *In Re Reed* the court concluded
 - that the IRS's interpretation that the filing of a Form 1099-C does not prohibit further collection of an indebtedness against a debtor was unreasonable and not entitled to deference when a debtor has, as required by the Internal Revenue Code, relied on the Form 1099-C and included the discharged or cancelled debt in gross income for the purpose of determining the debtor's taxable income.
 - According to the bankruptcy court, it is inequitable to require a debtor to claim cancellation-of-debt income as a component of his or her gross income and subsequently pay taxes on it while still allowing the creditor, who has reported to the IRS and the debtor that the indebtedness was cancelled or discharged, to then collect it from the debtor.
 - Cancellation-of-debt income, the court said, is not required to be reported to the IRS unless one of the express identifiable events occurs. The court found that if a financial institution has filed a Form 1099-C with the IRS, cancellation or discharge of a debt has, in fact, occurred.

Practical Tips:

- Even under this interpretation, only the principal amount of the debt is cancelled. Any interest, collection costs, or attorney's fees due and owing to a creditor that were incurred but not collected prior to the filing of the 1099-C are still owed to the creditor and subject to collection.
- Given the split on Court by the Courts regarding collection post 1099-C it is suggested that caution be used in determining whether collection continue post-1099-C issuance.

Collection After 1099 Filing

Highlights:

- Collection efforts may continue when a 1099-A is issued.
- The law is unclear as to whether collection efforts may continue once a 1099-C is issued; however it has been suggest in the minority of Court opinions that common sense would dictate that a creditor can't have it both ways: either you forgive the debt or continue to collect the debt or sell it, but not both.
- Surprisingly the IRS has issued no rulings, only informational letters regarding collections once a 1099-C is issued; although, if payment is received by the creditor once the 1099-C is issued the 1099-C must be reversed. Always issue a 1099-C once the debt is uncollectable and cancelled and a IRS "Identifiable Events" test has been met.

Practical Tips:

- Once a 1099-A is issued the debt remains collectable and all collection efforts should be pursued.
- The majority of bankruptcy courts, in interpreting IRS code, have ruled that the filing of a 1099-C is not an admission that a debt is no longer due, and is merely an attempt by the creditor to comply with IRS reporting regulations.
- However, as recent minority rulings have come to the opposite conclusion, the continuation of the collection of a debt post-1099-C should be carefully considered.
- In the event the member wishes to pay the outstanding debt once a 1099-C is issued, payment can be made at a future date, and if accepted the Credit Union would be required to file an amended 1099 rescinding the previously filed 1099-C.

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