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"The Issuance of a 1099-C and The Fair Credit Reporting Act"

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"The Issuance of a 1099-C and The Fair Credit Reporting Act"

There is no bright line rule regarding what should be reported on a consumer's credit report when a 1099-C is issued. Although the IRS has provided some guidance in various information letters, federal and state courts have interpreted the IRS guidance in different ways. Nationwide, courts differ as to whether issuing a 1099-C extinguishes a debt and prohibits a creditor from pursuing collection or reporting the debt. While it appears that the district and circuit courts are holding that the existence of a 1099-C form does not, alone, operate to distinguish a debt, some courts of limited jurisdiction have held that it is inequitable to allow a creditor to belatedly enforce the alleged debt after it received the tax benefit of the charge-off.

I. THE FAIR CREDIT REPORTING ACT & 1099-C

A. When Is a Form 1099-C Required

A 1099-C is issued when "any applicable entity . . . discharges an indebtedness of any person . . . of at least $600 during a calendar year." *See generally* 26 U.S.C. § 6050P (2012); 26 C.F.R. § 1.6050P-1 (2013). The entity must then "file an information return on Form 1099-C with the Internal Revenue Service." 26 C.F.R. § 1.6050P-1(a). For purposes of the reporting requirements of these sections, "a discharge of indebtedness is deemed to have occurred . . . if and only if there has occurred an identifiable event described in paragraph (b)(2) of this section,

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whether or not an actual discharge of indebtedness has occurred on or before the date on which the identifiable event has occurred." *Id.*

The Internal Revenue Code then lists nine factors that trigger the issuance of a 1099-C, including the expiration of the statute of limitations to collect on a breach of contract (6 years in New York), the decision or policy to discontinue collection and the expiration of the 36 month nonpayment testing period. *Id.*

B. The IRS Weighs In on the Impact of a 1099-C

The IRS has provided some guidance regarding whether the issuance of a 1099-C cancels a debt. In Information Letter 2005-0207, the IRS explained: "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." The Information Letter was addressed to a company "in the business of purchasing debts in large pools at a significant discount" in answer to its "request [for] information concerning the reporting obligations under section 6050P(c)(2)(D), [the IRS Code section for Returns Relating to The Cancellation of Indebtedness by Certain Entities,] for an organization that purchases debt."

The IRS further expanded on 1099-C in Information Letter 2005-0209:

> Q5. Does filing a Form 1099-C upon the occurrence of an identifiable event prohibit future collection activity on the amount reported?

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> A5. Section 1.6050P-1(a)(1) of the regulations provides that solely for purposes of the reporting requirements of section 6050P of the Code, a discharge of indebtedness is deemed to have occurred upon the occurrence of an identifiable event whether or not there is an actual discharge of indebtedness. Section 6050P and the regulations do not prohibit collection activity after a creditor reports by filing a Form 1099-C.

In its answer, the IRS references the language quoted above from 26 CFR 1.6050P-1.

One court has interpreted this regulation to mean that "a form 1099-C is "informational" and that it must be filed "whether or not an actual discharge of indebtedness has occurred." *In re Sarno*, 463 B.R. 163, 168 (Bankr. D. Mass. 2011).

C. The Fair Credit Reporting Act and Creditor Obligations

The Fair Credit Reporting Act (FCRA") was enacted "to require that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit . . . in a manner which is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information." 15 U.S.C. § 1681(b) (2012). To achieve this purpose, the FCRA places distinct obligations on three types of entities: consumer reporting agencies ("CRAs"), users of consumer reports and furnishers of information to CRAs. *See generally* 15 U.S.C. §§ 1681b, 1681m, and 1681s-2. Accordingly, consumers often turn to the FCRA when issued a 1099-C to dispute the information reported in a credit report.

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To prevail on a FCRA claim pursuant to § 1681s-2(b), a plaintiff must allege and establish that he notified a CRA that he disputed the completeness or accuracy of information in his credit report that was furnished by the defendant and that the CRA gave notice of plaintiff's dispute to defendant as a furnisher, and defendant did one of the following: (1) failed to conduct a reasonable investigation of the identified dispute; (2) failed to review all relevant information provided by the CRA; (3) failed to report the results of its investigation to the CRA; or (4) if an item of information disputed by plaintiff was found to be inaccurate, incomplete, or it could not be verified after any reinvestigation, failed to modify, delete, or permanently block the reporting of that item of information. *See, e.g.*, *Ware v. Bank of Am. Corp.*, 2013 U.S. Dist. LEXIS 186740, at *20 (N.D. Ga. December 4, 2013) (finding no violation of FCRA when defendant provided plaintiff with 1099-C and plaintiff offered no evidence that defendant's investigation was unreasonable).

Furthermore, a furnisher of information is entitled to summary judgment if it conducts a "reasonable investigation" based upon the information regarding the dispute provided by the CRA, concludes that there is no evidence that the information is inaccurate, and accurately reports its findings to the consumer reporting agencies. *See Westra v. Credit Control of Pinellas*, 409 F.3d 825, 827 (7th Cir. 2005) (concluding that creditor's verification of personal identifiers of accountholder, including name, address, and date of birth, was a reasonable procedure and investigation, given the scant information it received from the CRA regarding the nature of the dispute).

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In *Grossman v. Barclays Bank Del.*, for example, the plaintiff alleged that the bank reported inaccurate information to the CRA and should be liable under FCRA § 1681s-2(b). 2014 U.S. Dist. LEXIS 20149 (D.N.J. 2014) The court held that the defendant bank did not violate the FCRA § 1681s-2(b) when it sent a 1099-C cancellation of debt form to plaintiff and reported to the CRAs that the account was settled for less than the full amount pursuant to the Credit Reporting Resource Guide ("CRRG").[1] *Id.* at *35. Citing Third Circuit precedent, the *Grossman* court emphasized that "[i]t is only when the furnisher fails to undertake a reasonable investigation following . . . notice [from a credit reporting agency] that it may become liable to a private litigant under § 1681s-2(b)." *Id.* at *30 (citing *SimmsParris v. Countrywide Fin. Corp.*, 652 F.3d 355, 359 (3d Cir. 2011)). There, because the defendant's reporting of the plaintiff's account was done pursuant to CRRG guidelines, the reporting was reasonable as a matter of law, and the defendant was entitled to summary judgment.

Similarly, in *Ware v. Bank of Am. Corp.*, plaintiff brought an action alleging, *inter alia*, that defendant violated the FCRA by reporting a delinquent debt on the plaintiff's credit report after defendant sent plaintiff a 1099-C cancellation of debt form. 2013 U.S. Dist. LEXIS 186740, at *17-18 (N.D. Ga. December 4, 2013). Defendant moved for summary judgment, arguing that a Form 1099-C does not discharge a debt, and that plaintiff's debt remained

[1] The CRRG requires a furnisher to report the following information: (1) the dollar amount of the scheduled monthly payment due for the reporting period; (2) the account status code which identifies the status of the account within the activity period being reported; (3) a special comment providing additional information about the account; and (4) the current balance and amount past due on the account as of the date of transmittal.

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outstanding despite the issuance of the Form 1099-C. *Id.* at *26. Accordingly, defendant argued that that plaintiff could not demonstrate entitlement to relief under the FCRA. *Id.*

The court found that while FCRA § 1681s-2(b) creates a private cause of action, that cause of action is not triggered unless a defendant fails to perform a reasonable investigation after receiving notice from a CRA of a consumer's dispute concerning the completeness or accuracy of the information in the consumer's credit report. *Id.* at *19-20. Because the plaintiff failed to present facts showing that the defendant's investigation was unreasonable, the defendant was entitled to summary judgment. *Id.* at 24.

Factual v. Legal Determinations

To establish a cause of action under the FCRA, plaintiffs must allege that there is a factual disagreement about the status of their debt and not just offer legal conclusions that their debt no longer exists. *See Chiang v. Verizon New England Inc.*, 595 F.3d 26, 38 (1st Cir. 2010) ("We emphasize that . . . plaintiff's required showing is *factual* inaccuracy, rather than the existence of disputed legal questions . . . [l]ike CRAs, furnishers are neither qualified nor obligated to resolve matters that "turn on questions that can only be resolved by a court of law."); *Murphy v. Ocwen Loan Servicing, LLC*, 2014 U.S. Dist. LEXIS 21573, at *22 (E.D. Cal. 2014) ("A furnisher cannot be expected to report information only after independently addressing a possible legal objection as to the status of a debt.").

II. THERE IS NO BRIGHT LINE RULE REGARDING THE IMPACT OF A 1099-C

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A. Some Courts Have Found That A 1099-C Does Not Evidence Discharge of the Debt

Some courts have found that the issuance of a 1099-C does not, alone, to extinguish a debt. *See, e.g.*, *Atchison v. Hiway Fed. Credit Union*, 2013 U.S. Dist. LEXIS 38532, *8 (D. Minn. 2013). In *Atchison*, the defendant credit union obtained a judgment against the plaintiff. *Id.* at *1. After attempting to collect from the plaintiff for over two years the credit union charged off the account as inactive and filed a 1099-C with the IRS. *Id.* at 2. Plaintiff applied for a mortgage, which was denied due to an item on his credit report showing a balance due to the credit union. *Id.* Plaintiff disputed the credit report, claiming that the debt owed to the credit union was canceled by the 1099-C. *Id.* Plaintiff commenced an action alleging, *inter alia*, that the defendant violated the FDCPA by misstating the status of his debt and violated the FCRA by inaccurately reporting to a CRA that his debt remains unpaid and outstanding. *Id.* *7. The court rejected the plaintiff's claims and found that "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" and thus "the issuance of a Form 1099-C does not, alone, operate to extinguish a debt." *Id.* *8-9.

Likewise, in *Owens v. Commissioner*, the Fifth Circuit observed that a 1099-C "evidence[s] an intention to cancel the loan, not . . . [an] actual cancellation of the loan." 2003 U.S. App. LEXIS 12481, at * (5th Cir. 2003). *See also*; *Capital One, N.A. v. Massey*, 2011 U.S. Dist. LEXIS 83817, at *10 (S.D. Tex. 2011) ("The IRS does not view a 1099-C as a legal admission that a debtor is absolved from liability for a debt."); *United States v. Reed*, 2010 U.S.

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Dist. LEXIS 96079, at *5 (E.D. Tenn. 2010) ("[A] Form 1099-C, as a matter of law, does not operate to legally discharge a debtor from liability on a claim that is described in the form."); *Carrington Mortg. Servs., LLC v. Riley (In re Riley)*, 478 B.R. 736, 744 (Bankr. D.S.C. 2012) (debtors' credit report and Form 1099-C received from the lender were "not dispositive" and were not "evidence that the note ha[d] been satisfied"); *Lifestyles of Jasper, Inc. v. Gremore*, 299 S.W.3d 275, 277 (Ky. Ct. App. 2009) ("[T]he regulations and I.R.S. rulings make clear that Form 1099-C is to be utilized for reporting purposes only, and not as evidence of actual discharge of indebtedness."); *Leonard v. Old National Bank Corp.*, 837 N.E.2d 543, 546 (Ind. Ct. App. 2005) (filing a Form 1099-C is merely an informational filing with the IRS done to report an event that has already happened, and thus does not operate to cancel debt itself).

In *Bononi v. Bayer Employees Fed. Credit Union (In re Zilka)*, the plaintiff made two arguments as to why the issuance of a Form 1099-C operates to fully discharge a loan. 407 B.R. 684, 688 (Bankr. W.D. Pa. 2009). First, plaintiff argued, a 1099-C is only issued when an identifiable event, such as a discharge of debt occurs. *Id.* Therefore, the issuance of a 1099-C "essentially constitutes an admission by Bayer that it -- and thus proves that Bayer -- discharged the Debtor from further liability." *Id.* Second, plaintiff argued that the defendant's "issuance of the Forms 1099-C itself operated to legally discharge the Debtor from further liability" *Id.*

The court rejected both arguments for many reasons. First, it adopted the position that the IRS 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, and that the IRS's interpretation was entitled to great

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deference. *Id.* Second, the IRS's interpretation "is consistent with the fact that Forms 1099-C are sometimes filed and issued in error, ultimately prompting the filing and issuance of corrected Forms 1099-C." *Id.* at 689. Third, a 1099-C, as a matter of law, does not operate to legally discharge debtors from liability on those claims that are described in the form. *Id.* Fourth, the court held that "the sole purpose behind filing and issuing a Form 1099-C is to satisfy an I.R.S. information reporting requirement regarding an event that has already happened" and this "purpose is a far cry from a purpose of discharging the obligation that is the subject of the Form 1099-C, which purpose/intent must accompany any voluntary act that would operate to discharge such obligation." *Id.* at 690.

B. Some Courts Find That Issuance of a 1099-C is Evidence of a Discharge

Unlike the cases cited above, some courts have been persuaded that it is inequitable to allow a creditor to belatedly enforce the alleged debt after it received the tax benefit of the charge-off. *See, e.g.*, *In re Crosby*, 261 BR 470, 474 (Bankr. Ct. D. Kan. 2001) ("The actual (or at least potential) tax consequences of the form make it inequitable to allow the [creditor] to enforce its claims against the debtors"); *Discover Bank v. Shimer*, 36 Misc. 3d 1214(A), 1, 957 N.Y.S.2d 263, 263 (N.Y. Dist. Ct. 2012) (holding that it is "inequitable to allow [a creditor] to belatedly enforce the alleged debt after it received the tax benefit of the charge-off"); *Amtrust Bank v. Fossett*, 223 Ariz. 438, 441, 224 P.3d 935, 938 (Ariz. Ct. App. 2009) (issuance of Form 1099-C after debt was written off is "prima facie evidence" that debt had been discharged by creditor, sufficient to create an issue of fact) *Franklin Credit Mgmt. Corp. v. Nicholas*, 2001

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Conn. Super. LEXIS 1908 (Conn. Super. Ct. July 12, 2001) ("It would be inequitable … to require that [Defendant] report the discharge of debt as income on his federal tax return or face the potential tax consequences and hold that the plaintiff may continue to hold him liable on the debt.").

Similarly, in *In re Reed*, the bankruptcy court stated that although it generally agreed with the assessment that the IRS requires financial institutions to issue a 1099-C as a reporting requirement, it disagreed with courts that conclude that "the issuance of a Form 1099-C does not, alone, operate to extinguish a debt." 492 B.R. 261, 269 (Bankr. E.D. Tenn. 2013). The bankruptcy court reasoned that the IRS interpretation in the above referenced information letters "is in direct conflict with the Internal Revenue Code and the fact that cancellation of indebtedness income is included within a debtor's gross income." *Id*. at 270. The court further determined that the issuance of a Form 1099-C reflects that a financial institution has, in accordance with 26 U.S.C. § 6050P and 26 C.F.R. § 1.6050P-1, discharged an indebtedness. *Id*. at 271.

As such, there is no bright line rule regarding whether the issuance of a 1099-C discharges an indebtedness. Furthermore, as this is still a developing area of the law, there are no cases to date that explicitly state what should be reported on a consumer's credit report when a 1099-C is issued or whether a satisfaction of judgment must be filed after the issuance of a 1099-C.

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