

ISSUING 1099-C “CANCELLATION OF DEBT”

As you get ready for tax season, don't forget about the 1099-C's which need to be issued to customers by generally by the end of January. The IRS requires that a 1099-C “Cancellation of Debt” be issued to charged off customers under certain circumstances and although the IRS has required the issuance of 1099-C's for a number of years, only recently have we heard of penalties being enforced for non-issuance. The current penalty for intentional disregard of the filing requirements is at least \$250 per 1099-C which can add up to a substantial amount if your operation has hundreds or even thousands of charge offs each year.

The regulations behind 1099-C's are quite confusing but there are a few things we know for sure. Dealers who do not have a related finance company are not required to issue 1099-C's. Only related and independent finance companies should be issuing 1099-C's.

The most common question regarding 1099-C's is to do with the timing of 1099-C issuance and whether the 1099-C is required to be issued in the same year as the company takes the bad debt deduction. The regulations regarding the issuance of a 1099-C discuss nine identifiable events which would cause the issuance of a 1099-C, all of which generally relate to when a company abandons or loses the right to pursue a debt. Charging off an account and abandoning or legally not being able to pursue a debt are two different concepts and therefore it may be possible to charge off a debt in one year and issue a 1099-C in a different year, it all depends on the facts and circumstances.

Some circumstances are more cut and dry though. If you have an agreement with a customer not to pursue the debt or you settle with a customer for less than the balance on the account, a 1099-C should be issued because you have lost the legal right to pursue the debt. If you are in a state where you have no legal recourse against customers after the repossession and you do not attempt any legal collections after the charge off, a 1099-C should be issued. If your company has a written policy to abandon legal collections on charged off accounts after a certain period of time, you should issue a 1099-C. If the statute of limitations runs out on a debt collection, then you should issue a 1099-C.

Many companies state that they pursue debt collections on charged off accounts indefinitely and therefore do not have to issue 1099-C's. This is a dangerous practice because there is always a point at which a company ceases collections on a charged off accounts and therefore we recommend companies have a written policy defining their collection policies and time lines so that 1099-C's can be issued timely. Companies have also expressed concern that customers may be upset about receiving a 1099-C however these customers are likely already receiving 1099-C's from credit card companies and other finance companies so are familiar with what a 1099-C and how it affects them. In addition, the 1099-C income is not taxable to customers who are insolvent under IRS regulations.

We also recommend that finance companies review their collection policies and procedures, including the nine identifiable events for the issuance of 1099-C's, with their attorney to ensure they are compliant with state and federal regulations.

This is a regulation that many companies have ignored for years, but with the recent penalties that have been issued, now is the time to get compliant.