

Reporting Discharge of Indebtedness

An “applicable financial entity” (AFE) that holds a debt of \$600 or more that is discharged during a calendar year is required to file Form 1099-C, Cancellation of Debt, with the Internal Revenue Service (IRS) and to provide a statement to the debtor. AFE’s must file Form 1099-C with the IRS on or before February 28 (or March 31, for electronic returns) of the year following the calendar year in which the indebtedness was discharged. The statement to the debtor must be furnished by January 31 of the year following the calendar year in which the indebtedness was discharged. In the Buy Here-Pay Here (BHPH) business, debts are generally discharged in one of three ways:

1. Discharge in Bankruptcy
2. Discharge by Expiration of Collection Statute
3. Discharge by Agreement

With the exception of debts discharged in bankruptcy, an AFE is required to report debt discharges on Form 1099-C when an “identifiable event” occurs respecting a discharged contract, and failure to report will subject the company to the imposition of federal tax penalties.

- 1. Discharge in Bankruptcy** – As mentioned above, debts discharged in bankruptcy are not considered “identifiable events” and therefore do not need to be reported.
- 2. Discharge by Expiration of Collection Statute** – Debt discharges by expiration of collection statute are not themselves “identifiable events” that trigger a reporting requirement. However, upon expiration of the “nonpayment testing period” (NTP), there is a rebuttable presumption that the debt has been discharged, thus triggering an “identifiable event.” The NTP is 36 months, plus any time during which collection activity is barred by a bankruptcy stay or similar state or local law prohibition.
- 3. Discharge by Agreement** – Debt Discharges by Agreement are considered identifiable events that trigger a reporting requirement for the calendar year in which they occur.

As a practical matter, we advise our BHPH clients to adhere to the following guidelines:

1. If not previously reported as a Discharge on NTP Expiration, report for the calendar year of its occurrence any Discharge by Agreement (because it is an identifiable event).
2. Never report a Discharge in Bankruptcy (these are exempt from reporting under the Consumer Bankruptcy Exemption).
3. Never report a contract’s Discharge by NTP Expiration if such contract was discharged prior to the NTP Expiration and the discharge was a:
 - Discharge by Agreement (because such discharge was reportable in its own right); or
 - Discharge in Bankruptcy (because, even though such a Discharge by NTP Expiration is an identifiable event, it should be exempt from reporting under the Consumer Bankruptcy Exemption);
4. Report a contract’s Discharge by NTP Expiration:
 - Only if (1) it was discharged prior to the NTP Expiration in a Discharge by Expiration of Collection Statute, and (2) it was not discharged prior to the NTP Expiration by any other means (i.e., Discharge by Agreement, Discharge in Bankruptcy).
 - Report any contract not previously discharged (by any event) as a Discharge by NTP Expiration for the calendar year of expiration of the first 36-month NTP during which there were no payments received.
5. Report only an unpaid principal balance of \$600 or more.

Given the potential penalties, it is imperative for those dealers engaging in the BHPH business to review their debt discharge reporting policy and ensure it is in compliance with the IRS guidelines. For more information on the 1099 reporting requirements, please contact a member of our [Buy-Here-Pay-Here Services Group](#) at 317.580.2000.