Internal Revenue Service

Number: **201217001**
Release Date: 4/27/2012

Index Number: 6050P.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PA:02
PLR-120765-11

Date:
January 27, 2012

Legend

Entity 1 =
Entity 2 =
Asset =
State X =
Date 1 =
Date 2 =
Date 3 =
Collection Remedy =

Dear :

This letter responds to the letter dated May 6, 2011, as supplemented by the letter dated August 9, 2011, submitted on behalf of Entity 1, requesting the following ruling:

Entity 1 is not required to file forms 1099-C with respect to the write-off of balances and charges pursuant to its settlement agreement because the discharge was not the result of an "identifiable event" listed in Treasury Regulation § 1.6050P-1(b)(2), but rather was required by operation of state law.

Facts

Entity 1 is a financial institution chartered by State X that provides its members with thrift services such as checking and savings accounts, certificates of deposit, a source of credit, and other financial services. Entity 2 was a service company that offered retail sale installment contracts from Asset dealers to financial institutions for the financing of the Assets and serviced those contracts including, when necessary, initiating default proceedings on behalf of the financial institution that held a security interest in the

Asset. Entity 1 acquired various Asset loan installment contracts and retained Entity 2 for servicing, collection and enforcement of those contracts.

On Date 1, consumers in State X filed a class action lawsuit against Entity 1 in the Circuit Court of State X alleging violations of State X law, including that the notices related to the Collection Remedy did not meet statutory notice requirements. The case was later removed to U.S. District Court, Western District of State X. On Date 2, the court denied Entity 1's Motion for Summary Judgment, and held that available remedies if the plaintiffs eventually prevailed included a bar against collecting deficiency judgments and the receipt of statutory damages. On Date 3, Entity 1 and class plaintiffs signed a Settlement and Release Agreement ("Agreement") settling the entire class action lawsuit. The Agreement provides, among other things, that Entity 1 shall close all accounts and write off any balances owed or claimed remaining as any deficiency on the loans, including judgment balances, that were the subject of the litigation. The Agreement provides for payments from Entity 1 to the class members out of the "Net Distributable Settlement Fund" provided by Entity 1. The Agreement further provides that all class members shall be responsible for paying any and all federal taxes due on payments made to them pursuant to the settlement. The Agreement provides that Entity 1 will request a Private Letter Ruling from the IRS supporting the parties' position that Entity 1 is not required to file information returns relating to the terms of the Agreement. The Notice of Proposed Class Action Settlement that Entity 1 sent to the class members states that the request for Private Letter Ruling would be made by Entity 1 in support of the parties' position that the class members are not obligated to report the amount of the deficiency write-off or judgment write-off received as part of the settlement.

Law & Analysis

Section 6050P of the Internal Revenue Code requires that an applicable entity report any discharges (in whole or in part) of indebtedness of any person in excess of $600.00 The report is to include the name, address and TIN of each person whose indebtedness is discharged, the date of the discharge and the amount of indebtedness discharged. In addition, section 1.6050P-1(b)(2) of the Treasury Regulations provides that a discharge of indebtedness occurs if one of the following "identifiable events" takes place:

> (A) A discharge of indebtedness under title 11 of the United States Code (bankruptcy);
> (B) A cancellation or extinguishment of an indebtedness that renders a debt unenforceable in a receivership, foreclosure, or similar proceeding in a federal or state court, as described in section 368(a)(3)(A)(ii) (other than a discharge described in paragraph (b)(2)(i)(A) of this section);
> (C) A cancellation or extinguishment of an indebtedness upon the expiration of the statute of limitations for collection of an indebtedness, subject to the limitations described in paragraph (b)(2)(ii) of this section, or

> upon the expiration of a statutory period for filing a claim or commencing a deficiency judgment proceeding;
> (D) 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 of the indebtedness;
> (E) A cancellation or extinguishment of an indebtedness that renders a debt unenforceable pursuant to a probate or similar proceeding;
> (F) A discharge of indebtedness pursuant to an agreement between an applicable financial entity and a debtor to discharge indebtedness at less than full consideration;
> (G) A discharge of indebtedness pursuant a decision by the creditor, or the application of a defined policy of the creditor, to discontinue collection activity and discharge debt; or
> (H) The expiration of the non-payment testing period, as described in paragraph (b)(2)(iv) of this section.

Out of the above events, only two have a potential bearing on the requested ruling. The first possible event, section 1.6050P-1(b)(2)(F), provides that an identifiable event exists if the applicable financial entity and debtor agree to discharge the indebtedness for less than full consideration. To establish consideration, there must be a performance or a return promised which has been bargained for by the parties. Restatement (Second) Contracts § 71(1) (1981). In this case, Entity 1 and the debtor-class members agreed to the entry of a judgment, approved and supervised by the court, that incorporates the parties' Agreement by which Entity 1 will write off all remaining debt balances as part of the overall settlement of the pending litigation. This appears, on its face, to be the identifiable event described in subsection (F) of the regulations. The request for the PLR submitted on behalf of Entity 1, however, argues that the Agreement does not reflect a mere agreement of the parties. Entity 1 argues instead that the Agreement reflects the operation of the law of State X. The law of State X provides that, in a case where the Collection Remedy did not strictly comply with notice requirements, there is an absolute bar on collection of any remaining deficiency balances. The class members alleged that Entity X violated various aspects of the notice requirements in the three types of notices that Entity X sent to the class members as part of its Collection Remedy. Entity 1 never specifically admitted to violating the notice requirements, however, and the Agreement contains a statement that Entity 1 is not making any admission or concession with respect to the claims or defenses alleged in the litigation, including any alleged violation of federal, state or local law. Thus, although the law of State X does provide for "strict compliance" in observing the requirements for sufficiency of notices to debtors, Entity 1 has not established, nor do the terms of the Agreement provide, that the notices were, in fact, deficient.

The request for the ruling argues that the law of State X required the bar on the recovery balances due to the defective notices, and the only real issue once the court had certified the class action lawsuit was the amount of damages to be awarded to the

class members. The Agreement contains an acknowledgement that the class members' claims are premised on the state law bar on recovery of deficiency balances, and that the amounts of the individual settlement awards would be determined by application of state law; however, there is no definitive finding or admission in any documents related to the case that the notices were defective. The court's Order on Date 2 by which it denied Entity 1's Motion for Summary Judgment specifically states that "one of the main issues to be decided in this case is whether Defendant [Entity 1] gave Plaintiff [class representative] the notice statutorily required." [1]

Entity 1 did admit, for purposes of opposing the Plaintiff's Motion for Class Certification, that it "*may be*" barred from obtaining a deficiency judgment "*if* it failed to give notice required by the UCC" (emphasis added). The closest thing to an admission by Entity 1 that some of its notices may have been deficient is the statement in its Suggestions In Opposition to Plaintiff's Motion For Class Certification that "each of the seventy-six (76) proposed class members who received a 'pre-sale' notice sent after May 2005 received a notice that clearly satisfied the requirements of the law of the state governing their UCC claim." Entity 1 made a similar statement in support of its motion for leave to file an amended answer and counterclaim. This appears to be a tacit admission that the notices sent to the other 28 class members might have been defective. In its Motion for Summary Judgment, filed after the court certified the class, Entity 1 admitted, solely for purposes of the motion, that it "assumes *arguendo* that the 'pre-sale' notice sent to plaintiff does not comply with section 9-614 of the [State X] UCC. However, [Entity 1] maintains that the pre-sale notices sent to the majority of the 103 other proposed class members do comply with the requirements of the UCC applicable to each of them." This admission solely for purposes of resolving a potential factual dispute so that the court could rule on the Motion for Summary Judgment falls short of an actual admission that the notices were defective and that recovery was barred by state law. As stated above, the court denied the motion and explicitly held that the issue of the adequacy of the notices remained in dispute.

The Agreement states that it was reached for the purpose of "avoiding the burdens, expense, and risk of further litigation." The court approved the Agreement without taking any further action. It did not make any ruling as to the adequacy of the notices.

The request for PLR is essentially asking the IRS to make a determination that the notices to the debtors were inadequate and that Entity 1 was therefore barred by statute from collecting the balances owed. The request alleges that the parties to the lawsuit agreed among themselves that, at the time of the settlement, there was in fact no legal dispute about whether the application of state law would bar the recovery of the deficiency balances and that the allegedly defective "pre-sale" notices had acted to bar all future collection activity.

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[1] The Order also decided a conflict of laws issue in holding that the law of State X did not apply, but rather that the law of another state would apply. The Order determined, however, that laws of both jurisdictions provided for the same available remedies.

The court overseeing the class action lawsuit did not make a determination as to the sufficiency of the notices, however, and it is not within the purview of the IRS to do so in this private letter ruling. The actions of the court in overseeing the litigation, including certifying the class, ruling on parties' motions, and approving the class action settlement, do not serve to convert the forgiveness of the debt from being entered into voluntarily to one forced by operation of state law. The Agreement should be taken on its face as an agreement between Entity 1 and the debtors to discharge the indebtedness at less than full consideration. Thus, section 1.6050P-1(b)(2)(F) applies.

The second possible event, section 1.6050P-1(b)(2)(G), provides that a discharge of indebtedness exists if a creditor discontinues collection activity pursuant to a decision by the creditor or a defined policy of the creditor. According to section 1.6050P-1(b)(2)(iii), a creditor's defined policy includes both a written policy and the creditor's established business practice. In this case, the cancellation of indebtedness does not appear to have been as a result of any defined policy or business practice of Entity 1, but rather by its decision to discontinue collection action as part of settling the litigation. This decision appears to fall within subsection (G). In any event, regardless of whether subsection (G) of the regulation applies, the event set forth in regulation subsection (F), as set forth above, does apply and the section 6050P reporting requirements must be met.

Conclusion

Based solely on the information provided and the representations made, we conclude that Entity 1 is required to file Forms 1099-C with respect to the write-off of balances and charges pursuant to its settlement agreement because the discharge was the result of an identifiable event listed in section 1.6050P-1(b)(2) and not by operation of state law.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

To the extent that this ruling is in conflict with other factually similar rulings that were previously issued, the prior rulings are limited to their recipients and have no precedential value. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Ashton P. Trice
Chief, Branch 2
(Procedure & Administration)

Enclosures (2)