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11/27/2017

Attn: Laurie E. Brimmer, Senior Tax Analyst
Internal Revenue Service
1111 Constitution Avenue NW
Room 6526
Washington, D.C. 20224

Dear Ms. Brimmer,

Enclosed please find comments submitted in response to 82 FR 45675. If you have any questions about these comments, please feel free to contact me at 617-390-2532 or by email at kfogg@law.harvard.edu.

Keith Fogg

A handwritten signature in blue ink that reads "Keith Fogg".

Director of Federal Tax Clinic at Legal Services Center of Harvard Law School
122 Boylston St
Jamaica Plain, MA 02130



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Internal Revenue Service
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Washington, D.C. 20224

The following comments were composed in a joint effort between the Project on Predatory Student Lending and the Tax Clinic at the Harvard Legal Services Center together with the University of Minnesota Law School Federal Tax Clinic. They include specific student contributions from Katherine Sass and Joel Phillips at Harvard Law School and Matthew Barron at the University of Minnesota Law School. The comments reflect the opinions of the respective clinics, but not necessarily of their respective law school employers.

In 82 FR 45675 the Treasury requested comments on, among other things, “whether the collection of information is necessary for the proper performance of the functions of the [IRS], including whether the information shall have practical utility.” The request focused especially on the withdrawn Treasury Regulation establishing a 36-month non-payment testing period (the “36-month Rule”) previously triggering the issuance of Form 1099-C. Our comments focus on the issuance of Form 1099-C under the 36-month rule and in the context of student loan debt cancellation. We use these two contexts as respective case studies in how the IRS can model best practices for the use of information returns to further its mission, while minimizing the burdens on taxpayers and creditors. Our conclusions are that policies which over-zealously encourage Form 1099-C issuance by creditors result in substantial costs and inefficiencies to the IRS in

both collection and compliance functions. Furthermore, such policies may adversely affect the rights of the most vulnerable taxpayer populations.

Over-Zealous Information Reporting: General Causes and Concerns

Over-zealous information reporting is likely to occur where rules (1) readily punish parties that fail to submit information returns, (2) fail to readily punish parties that submit information returns they shouldn't have, and (3) set unclear requirements for when 3rd parties are required to submit information returns. Under the above considerations, when faced with uncertainty about their requirement to issue an information return a rational party would always err on the side of issuing.

The first two elements of an over-zealous information reporting problem are evident in the Internal Revenue Code (“IRC”) §§ 6721 - 6723 as compared to § 7434. The penalties under IRC §§ 6721 – 6723 encourage filing a correct information return. The penalties have the potential to be substantial: generally the penalty is \$250 per failure to report up to a cap of \$3,000,000.¹ There is also a fairly low threshold for this penalty to apply: there is no “malice” or “neglect” requirement for failing to issue an information return.

Conversely, a taxpayer that receives an information return they believe is inaccurate has a much more difficult legal hurdle against the issuer.² For damages against the issuer, the taxpayer would need to show fraud in the issuance of the information return.³ Current case law suggests that the fraud would need to go beyond just the “type” of Form that was issued, to the numbers underlying it.⁴ Furthermore, the financial exposure for filing information returns that individual taxpayers believe are inaccurate are unlikely to be substantial: for one, because individual parties would have to bring suit (rather than the IRS seeking to administratively assess penalties),

¹ IRC § 6721(a)(1). Note that the penalties can ramp up significantly (and a cap on total penalties may no longer apply) if the reporting failure is due to intentional disregard. See IRC § 6721(e).

² Note that where there is a reasonable argument as to whether a 1099-C should have been issued, the creditor can avoid penalties if they had “reasonable cause” to issue. See IRC § 6724. Unlike other, more cut-and-dry reporting requirements (like wages), cancelled debt tends to lend itself to reasonable arguments on amount of debt or if and when the debt was actually cancelled.

³ IRC § 7434(a)

⁴ See *Liverett v. Torres Adv. Ent. Sols. LLC*, 192 F.Supp.3d 648 (2016)

and for two because IRC § 7434 penalties are generally limited to actual damages surrounding the fraudulent issuance of the information return.⁵ Thus, as it stands, there is generally a pressure for 3rd parties to issue information returns rather than not. This pressure may not distort or have particularly negative effects in areas where the rules are clear on when an information return should be filed (for example, with W2 wages). However, where the rules are not clear this pressure can wreak havoc. This is especially concerning where the information return does not accurately reflect the nature of the actual transaction, giving the IRS a faulty picture of the tax consequences that should apply. One can see all these concerns playing out with cancelled debt and the 36-Month Rule reporting requirement.

The 36-Month Rule: Problems with Narrow Focus on Creditor Clarity

The 36-Month Rule was created in large part to provide greater certainty to creditors about when they are required to issue Form 1099-C. Instead of an inherently subjective “facts and circumstances” test to determine if a discharge of indebtedness had occurred (triggering the issuance of Form 1099-C for the creditor), the 36-Month Rule embodied an objective, easily administrable approach. Coupled with the rule that a creditor need not issue more than one Form 1099-C for a debt that has previously been deemed discharged,⁶ one may believe that concerns of over-zealous information reporting in this context is mitigated. However, the 36-Month Rule demonstrates that no matter how clear the rule for information reporting may be, if it does not place adequate focus on the transactional reality underlying the information being reported it will fail to serve any useful purpose.

The trade-off to the ease of applying 36-Month Rule for creditors was that it was less likely to reflect the transactional reality for the debtor. Indeed, the 36-Month Rule created a system whereby creditors could properly issue Form 1099-C (thus discharging their IRS reporting obligation) while still treating the debt as collectible (thus refraining from discharging the debt).⁷

⁵ IRC § 7434(B)

⁶ See Treas. Reg. § 1.6050P-1(e)(9)

⁷ See, e.g. *In Re Reed*, 492 B.R. 261 (Bankr. E.D. Tenn. 2013) (listing bankruptcy court decisions that do not treat issuance of Form 1099-C by a creditor as an extinguished debt. Note also in this case that the taxpayer listed the information from the Form 1099-C as taxable income.)

As stated in the Treasury decision withdrawing the 36-Month Rule regulation, this resulted in scenarios where a taxpayer “may conclude that the debts have, in fact, been discharged, causing the taxpayers to erroneously include in income the amounts reported on Forms 1099-C even though creditors may continue to attempt to collect the debt[.]”⁸

Because the 36-Month Rule discharged the creditor’s reporting requirement⁹ (and therefore their exposure to reporting penalties) but carried no other significant consequence to the creditor¹⁰ there was no pressure on the creditor to worry about the true status of the debt. A creditor “on the fence” about whether the 36-Month Rule applied (and thus whether to submit Form 1099-C) rationally would opt to submit. The IRS (and taxpayers) were thus likely to be inundated with significant numbers of information returns that were not accurate. The downstream costs of this over-zealous reporting are myriad.

The 36-Month Rule: True Costs of Over-Zealous Information Reporting

The Treasury currently estimates that filing Form 1099-C takes roughly 13 minutes.¹¹ However, the life-cycle of Form 1099-C does not end or culminate in the issuance of the Form. The real time and burden associated with Form 1099-C is best understood not from the perspective of the issuer, but from that of the recipients: that is, the IRS and the taxpayer. The initial issuance of Form 1099-C carries cascading time burdens on the recipients that dwarf the burdens of the issuers. This may best be illustrated by the life-cycle of Form 1099-C issued pursuant to the 36-Month Rule.

Beginning with the taxpayer perspective, the initial time-burden faced on receiving Form 1099-C is in determining how to properly report the Form on a tax return. Discharge of indebtedness

⁸ T.D. 9793

⁹ Treas. Reg. § 1.6050P-1(e)(9)

¹⁰ Note that the reporting requirements explicitly say that the discharge is “deemed to have occurred” (i.e. may be a legal fiction) “whether or not an actual discharge of indebtedness has occurred” based on the applicable rules. See Treas. Reg. § 1.6050P-1(a). Thus, a debtor arguing against a creditor trying to collect a debt they believe is discharged will not find much solace in pointing to a Form 1099-C, regardless of the fact that the Form 1099-C seems to explicitly say the debt was discharged. Note also the previously discussed difficulty of suing a party for improperly issuing a Form 1099.

¹¹ FR Doc. 2017-20875, *Estimated Time per Response*

may be treated as (1) fully taxable income,¹² (2) fully excluded from taxable income,¹³ (3) partially excluded from taxable income.¹⁴ The nature of the debt, the reason for the discharge, and even the financial situation of the debtor determines how to properly report the discharge.¹⁵ The taxpayer is in a good position to know the nature of the debt and their own personal financial situation, but in many circumstances they rely on the creditor for the “reason” for the discharge.¹⁶ Form 1099-C would, ostensibly, provide this critical information to the taxpayer and IRS.¹⁷ In fact, however, the Form only lists the reason why the creditor had to *issue the Form*: not necessarily why or even if the debt was *discharged*.

Of course, if a debt is not actually discharged a taxpayer need not consider if it is fully taxable, excluded, or partially taxable: one cannot possibly have discharge of indebtedness income if the indebtedness was not actually discharged. On receiving a Form 1099-C for discharge that results from the 36-Month Rule the taxpayer is thus burdened with an additional, and not likely simple, task of further investigating whether the debt actually was discharged, and if so when. If the debt was not discharged (or if a good argument can be made by the taxpayer that it was not, or was not during the year at issue), the life-cycle of the Form 1099-C matures into a very time-consuming burden.

Consider the taxpayer receiving Form 1099-C under the 36-Month Rule but with no actual discharge of indebtedness (or who would like to argue that there was no actual discharge). How do they report this on their tax return? Since there was no taxable event, arguably they should not have to report anything: there is no exclusion, there is no election or reduction of taxable attributes. This would seem to be simple solution, with very little time-burden on the taxpayer. However, that relief is short lived.

¹² See IRC § 61(a)(12) for the general rule that discharge of indebtedness is gross income.

¹³ See, e.g. IRC § 108(a)(1)(A)

¹⁴ See, e.g. IRC § 108(a)(3)

¹⁵ Note also the additional complexity that arises through exclusion of indebtedness income under code sections IRC § 108(a)(1)(A – C), which require reducing tax attributes (essentially deferring the taxable nature of the income rather than fully excluding it).

¹⁶ For example, a taxpayer would likely know and understand that their debt was discharged due to bankruptcy, but may be less aware of discharge due to a defined policy of the creditor (Treas. Reg. § 1.6050P-1(b)(2)(i)(G)).

¹⁷ See Form 1099-C Box 6 “Identifiable Event Code.”

The “silent” tax return treatment at first shifts the time-burden to the IRS. The IRS generally compares individual tax returns against 3rd party information returns associated with those individuals to ensure that they “match.” Returns with discrepancies may get selected for further examination via the “Automated Under-Reporter” (AUR) function.¹⁸ A return omitting Form 1099-C that does not have either bankruptcy or foreclosure as the reason for the 1099-C issuance is likely to result in additional analysis by IRS employees.¹⁹ After examination by the AUR Tax Examiner, if “reasonable doubt” still exists as to the treatment by the taxpayer a CP 2000 Notice is generally issued.²⁰

A taxpayer issued a CP 2000 Notice will thereafter receive a Notice of Deficiency (NOD) if they do not respond.²¹ Similarly, if they respond to the CP 2000 but the response does not convince the AUR Tax Examiner, a NOD will issue. At that stage, for the taxpayer to forestall assessment of the tax they will need to timely petition the Tax Court -another burdensome activity, that generally carries a \$60 filing fee. On filing the petition, the Tax Court would docket the case, and IRS counsel would be required to file an answer.²² This, in turn, would require costly allocation of IRS Counsel resources for investigating the case.²³ After that, the case would likely be assigned to IRS Appeals for settlement. Clearly, the creation of a dispute based on an information return that does not accurately reflect the transactional reality (but was correctly issued under the 36-Month Rule) runs the risk of wasting large amounts of taxpayer time and expensive IRS resources.

Because most taxpayers receiving a notice of deficiency do not petition the Tax Court, the liability will likely go into collection. A taxpayer who disagrees with the assessment can initiate an audit reconsideration of the liability which would also waste the time of the IRS and the

¹⁸ See 4.19.3.2. Note that not all information returns are likely to trigger additional scrutiny: see TIGTA Report Ref. No. 2017-30-083 (detailing the frequent failure of the IRS to compare information on Form 1099-K with taxpayer returns).

¹⁹ See IRM 4.19.3.8.20

²⁰ See IRM 4.19.3.2 (11)

²¹ See Form CP 2000, Page 1 “If We Don’t Hear From You.” (Example Retrievable here: https://www.irs.gov/pub/NOTICES/CP2000_english.pdf)

²² Tax Court Rule 36. Note also that even in designated “Small” Cases the IRS is required to file an answer: Tax Court Rule 173(b). The existence of the Tax Court case not only places a burden on Chief Counsel’s Office and the Appeals Office but also on the Tax Court which must expend resources to docket and manage the case.

²³ See Tax Court Rule 33(b).

taxpayer. Taxpayers in collection who have had debts discharged are also more likely than the average taxpayer to have low collection potential causing the IRS to spend money on the collection notice stream and other collection actions with little return.

The 36-Month Rule: Confounding a Taxpayer’s “Right to Be Informed” and “Pay No More Than the Correct Amount of Tax”

Behind the time spent responding to an incorrect information return a different fundamental issue lurks: the *capacity* of the taxpayer to sufficiently respond to both the Form 1099-C and the IRS. The above analysis presupposes a taxpayer that knows (or at least suspects) that the Form 1099-C has not resulted in a taxable transaction because the debt was never discharged. From the outset, it is not unfair to assume that many taxpayers receiving Form 1099-C may reach quite the opposite conclusion: that they have taxable income they must report.²⁴ In such cases, vulnerable taxpayers may accrue tax liabilities they do not have the ability to pay (and should never have had to pay). “Undoing” a tax return that reports income it should not have is similarly time-consuming and costly.²⁵ The tax reported on the return is automatically assessed, so the taxpayer generally moves directly into collection. If the taxpayer is unable to full-pay, they can file an administrative request for audit reconsideration with the IRS, but the IRS is not statutorily required to respond to a 1040X and advises that responses may take up to 16 weeks.²⁶

It is also not unfair to assume that a large portion of taxpayers that receive Form 1099-C are low-income and not well-versed in tax law, or lack access to professional tax assistance. This may be especially true for taxpayers that have their debt discharged because the creditor determines it is not collectible (or has simply stopped trying to collect, via the 36-Month Rule). It should be noted that Volunteer Income Tax Assistance (VITA) programs are not able to complete most tax returns that exclude cancelled debt.²⁷ Volunteers are also not trained on filing Form 8275, and it

²⁴ Indeed, the Treasury comments withdrawing the 36-Month Rule explicitly mention this possibility. See T.D. 9793 *Regulatory History*.

²⁵ The IRS estimates 10 hours of taxpayer time and \$170 to complete Form 1040X, the most common method of changing (“amending”) a tax return. See “Instructions for Form 1040X” (found here: <https://www.irs.gov/instructions/i1040x#idm140093720919504>)

²⁶ <https://www.irs.gov/filing/amended-return-frequently-asked-questions>

²⁷ See VITA training module at https://apps.irs.gov/app/vita/content/15/36_04_010.jsp?level=advanced

is likely out of scope. These vulnerable taxpayers thus must act alone to face a burden they are unable to meet with consequences that span from over-paying tax to being subject to CP 2000 notices and deficiency actions on tax they shouldn't owe. The interplay of the complexity of tax code treatment of canceled debt with the vulnerability of the population that is likely to incur it, warrants a heightened standard of information reporting so that the taxpayer is given a fair chance of complying with the law.

Finally, it is not clear that a taxpayer who discloses their argument against actual discharge of indebtedness on their Form 1040 will fare much better. There is no streamlined method or specific IRS Form for such a disclosure (unlike, for example, Form 982 for a discharge with insolvency). If the taxpayer return is not “silent” about the Form 1099-C, but explains via Form 8275 that they do not believe they actually had discharged debt it is unclear what course the IRS will take.²⁸ In any event, it appears that the IRS AUR function is tasked with taking a second-look at the return, thus contributing to an increased time-burden for the IRS. This investigation may or may not result in the issuance of a CP 2000 Notice, virtually replaying the events that unfolded on a silent return.

36-Month Rule: Takeaway Lessons

The IRS rightfully requires information returns so that it is not “flying blind” in its compliance mission. There is ample reason to believe that information returns promote voluntary compliance among taxpayers, thus reducing the IRS burden in audit and narrowing the tax gap.²⁹ Information returns comprise the IRS’s “first impression” of what the taxpayer’s return should look like. But a first impression can be both stubborn and deceiving. When a low-income taxpayer without ready understanding of a complicated area of the code is confronted with a first impression of the IRS that is not accurate, they may have more difficulty than other taxpayers in changing that impression. This holds especially true where the IRS audience is of limited discretion and

²⁸ The IRM publicly available on this point is heavily redacted. It is possible that IRM 4.19.3.21.3.16(4) addresses the issue.

²⁹ See “Tax Gap: A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Non-compliance,” GAO-07-1014 (July 2007).

training, as an AUR Tax Examiner generally is.³⁰ With regards to cancelled debt, particularly where the creditor has access to information that the debtor may not (but which effects the proper tax treatment for the debtor), it promotes effective tax administration to require more information from the creditor, or more discriminate rules of when Form 1099-C should issue. The burden on the information return issuer pales in comparison to the downstream costs and time-burden to the IRS and taxpayer. Getting it right the first time (or increasing the chance that it will be gotten right) very likely saves money even if it increases the upfront costs.

What the failure of the 36-Month Rule illustrates is that more information returns cause *more* problems for the IRS and taxpayers if the reported transaction is likely not taxable. Under the 36-Month Rule, creditors were in a better position than the taxpayer to know whether there was a taxable discharge of indebtedness: that is, if the debt was actually discharged or if the reporting requirement had merely been triggered. While the 36-Month Rule was wisely withdrawn, its lessons should be applied and considered in analyzing other Form 1099-C reporting issues.

Cancellation of Student Debts Based on School Misconduct³¹

Cancellation of student indebtedness based on school misconduct by for-profit schools provides yet another example of why Treasury regulations should not require the issuance of a 1099-C if the “identifiable event” leading to discharge is demonstrably non-taxable. Recently, Treasury determined that 1099-Cs should not issue for cancellation of federal student loans from two for-profit colleges found to have committed widespread misconduct.³² In Revenue Procedure 2015-57 and Revenue Procedure 2017-24, Treasury concluded that students from Corinthian Colleges, Inc., and American Career Institute, Inc., respectively, need not recognize income when they receive borrower defense loan cancellations. Treasury should extend this analysis to other for-profit schools and other forms of student debt.

³⁰ See Taxpayer Advocate 2013 Report, “Most Serious Problem #3: Employee Training: at <http://www.taxpayeradvocate.irs.gov/2013-Annual-Report/downloads/Most-Serious-Problems.pdf>

³¹ This portion of our comments draws on the expertise of the Project on Predatory Student Lending. As part of the Legal Services Center of Harvard Law School, the Project represents low-income student loan borrowers who have experienced unfair, deceptive, and otherwise illegal conduct at the hands of for-profit colleges. We represent former students of many for-profit institutions across the country, all of whom struggle to repay their debts from these schools. The comments that follow reflect these clients’ experiences.

³² See Rev. Proc. 2015-57, 2015-51 I.R.B. 863; Rev. Proc. 2017-24, 2017-7 I.R.B. 916.

In Revenue Procedure 2015-57 and Revenue Procedure 2017-24, Treasury presumptively applied two independent exceptions to the rule that income should accrue when a debt is cancelled. First, Treasury acknowledged that income does not accrue and a 1099-C need not issue for a cancelled student debt if school misconduct creates a “legal infirmity that relates back to the original sales transaction.”³³ Second, Treasury recognized that a former student of a for-profit college can “exclude from gross income a discharge of indebtedness that occurs when the taxpayer is insolvent.”³⁴ In the case of Corinthian and American Career Institute, Treasury applied these exceptions to all former students who receive borrower defense loan cancellations, a type of federal student loan cancellation predicated on schools’ violations of state law.³⁵ Because the same logic applies to educational debts from many other for-profit schools, Treasury should extend its presumptive application of the “legal infirmities” and insolvency exceptions to all cancellations of student indebtedness based on school misconduct by for-profit colleges. In addition, because students often incur private student loans and institutional debts in addition to federal student loans, Treasury should extend its analysis to encompass cancellation of these student debts as well.

Cancellation of Student Debts: Legal Infirmities

Because legal infirmities relating to school misconduct are not unique to debts from Corinthian Colleges and American Career Institute, Treasury should presumptively extend its legal infirmities analysis to all cancellations of student indebtedness resulting from school misconduct by for-profit colleges. In our experience, many for-profit schools commit unfair and deceptive conduct toward former students in violation of state law.³⁶ For instance, our clients have routinely been misled by their for-profit schools about the transferability of credits they would

³³ Rev. Proc. 2015-57 at 3; Rev. Proc. 2017-24 at 3.

³⁴ Rev. Proc. 2015-57 at 3; *accord* Rev. Proc. 2017-24 at 4.

³⁵ Rev. Proc. 2015-57; Rev. Proc. 2017-24; *see* 20 U.S.C. § 1087e(h) (providing for borrower defense cancellation); 34 C.F.R. § 685.206(c) (same); 34 C.F.R. § 682.209(g) (same).

³⁶ *See, e.g.*, Compl., *Colon v. DeVos*, No. 17-cv-8790 (S.D.N.Y., Nov. 12, 2017) (outlining misconduct at Sandford-Brown Institute); Class Action Adversary Proceeding Compl. at 10-48, *Jorge Villalba, James Eric Brewer, et al. v. ITT Educational Services, Inc.*, No. 16-07207-JMC-7A (Bankr. S.D. Ind. Jan. 1, 2017) (summarizing misconduct at ITT Technical Institutes); First Am. Compl., *Williams v. DeVos*, No. 16-cv-11949 (D. Mass Sept., 28, 2016) (summarizing misconduct at Corinthian Colleges, Inc.).

earn, externship opportunities they would enjoy, job placement rates they could expect, and earnings they would earn after graduation. Moreover, our clients often report being subjected to unfair recruitment tactics—including high-pressure sales calls, rushed enrollment meetings, and lies about enrollment deadlines—as well as other unfair practices—including targeting on the basis of gender and race, unsafe learning environments, and wholly inappropriate externship environments. And crucially, many of our clients report unfair and deceptive financial aid practices, including lies about the nature and consequences of student debt and pressure to incur debt. All of this conduct violates state law, entitles students to cancellation of their debts, and creates legal infirmities in the debts used to pay for attendance at the perpetrating schools.³⁷ Thus, any cancellation of student debts on the basis of such school misconduct should not give rise to income or trigger 1099-C reporting.

Unfortunately, misconduct of this kind is prevalent among for-profit colleges. Indeed, of the nearly 100,000 borrower defense loan cancellation claims received by the United States Department of Education as of August 15, 2017, over 98% were submitted by former students of for-profit colleges.³⁸ Moreover, this misconduct is not confined to a few bad actors. Among the 100,000 pending claims, forty-seven different schools generated twenty or more borrower defense claims each.³⁹ The pervasiveness of misconduct at for-profit schools and the abundance of predatory loan cancellation claims underscores the need for broad application of Treasury’s legal infirmities analysis when evaluating cancellation of indebtedness income related to such schools.

Cancellation of Student Debts: Insolvency

Similarly, the applicability of the insolvency exception is not limited to former students of Corinthian and American Career Institute. Treasury should presumptively apply this exception to cancellation of indebtedness from all for-profit colleges for three reasons.

³⁷ See, e.g., Amicus Brief of Commonwealth of Massachusetts at 3–4, 7, *Williams*, No. 16-cv-11949, available at <https://perma.cc/4FS6-6KDL> (enumerating widespread violations of Massachusetts law experienced by former Corinthian Colleges students and explaining that this misconduct renders their debts not legally enforceable).

³⁸ See Yan Cao & Tariq Habash, The Century Foundation, *College Complaints Unmasked* (Nov. 8, 2017), <https://perma.cc/D26X-XDPC>.

³⁹ *Id.*

First, for-profit colleges target low-income students. According to a 2012 study by the Health, Education, Labor, and Pensions Committee of the U.S. Senate, the annual median family income of students at for-profit colleges is \$23,000, compared to \$62,000 for students of private not-for-profit institutions and \$45,000 for students of public not-for-profit schools.⁴⁰ Indeed, in a recent internal survey, the Project on Predatory Student Lending estimated that over 90% of its clients who submitted borrower defense cancellation applications were eligible for Pell grants, which many experts consider a reliable proxy for low-income status.⁴¹ The prevalence of low-income students at for-profit colleges is no accident. Our clients often report that their for-profit schools used advertising and recruiting efforts specifically aimed at enrolling at low-income students, including recruiting recipients of government assistance and making false promises of high wages.⁴²

Second, for-profit colleges are more expensive than not-for-profit alternatives. On average, for-profit schools charge more than three-and-a-half times as much as public institutions within the same state.⁴³ Lower student family incomes and higher cost mean that students of for-profit colleges must incur large student debts to finance their education. Indeed, nearly all former students at for-profit colleges borrow money to finance their education, and they borrow more money than students at other types of schools.⁴⁴

Third, former students experience exceedingly poor employment outcomes after attending for-profit colleges. Our clients' financial outlooks do not improve after attending for-profit schools, and often they get worse. After being induced to incur large amounts of student debt to attend, our clients struggle to find employment in their fields and many return to the same jobs they had before they enrolled at for-profit schools. According to an expert report prepared for the Project

⁴⁰ U.S. Senate Health, Educ., Labor and Pensions Comm., *For-Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success*, 96 n.369 (July 30, 2012), <https://perma.cc/SUKJ-VWUJ> [hereinafter HELP Report].

⁴¹ Federal Pell Grant Program: Purpose, U.S. Dep't of Educ., <https://perma.cc/5FL5-U524> (last modified June 4, 2015).

⁴² *Accord*, HELP Report at 18 (reporting that for-profit colleges "often target their marketing to low-income independent students").

⁴³ *Id.* at 35.

⁴⁴ *Id.* at 7 ("Ninety-six percent of for-profit students take out student loans, according to the most recent U.S. Department of Education data.").

on Predatory Student Lending, many of our clients experience a decrease in income after attending a for-profit school. National studies corroborate this finding,⁴⁵ and suggest that former students of for-profit schools are more likely than their counterparts at not-for-profits to experience unemployment afterward.⁴⁶ With grim employment prospects, former students from for-profit colleges account for a disproportionate share of all student loan defaults nationwide.⁴⁷

The combination of low family income, high debt burden, and poor employment outcomes means that many former students of for-profit colleges whose student debts are cancelled on the basis of school misconduct qualify for the insolvency exception. Thus, Treasury should presumptively extend the insolvency exception to all such students.

Cancellation of Student Debts: Private Student Loans and Other Debts

Because former students of for-profit colleges often have other forms of debt beyond federal student loans, including private student loans and institutional debts, Treasury should extend its analysis to cover those types of debts as well. Students of for-profit schools often incur private student loans—loans not affiliated with the federal government⁴⁸—and institutional debts—accounts owed directly to schools not governed by promissory notes.⁴⁹ These loans are often especially burdensome for former students because they are not subject to federal protections and often have very unfavorable terms of repayment. Moreover, for-profit schools actively encourage these forms of payment in order to comply with the federal government’s “90-10 rule,” which mandates that schools receive at least 10% of their revenues from sources other than federal financial aid.⁵⁰ Although private student loans and institutional debts are not covered by the federal borrower defense process, they are subject to cancellation for the same school

⁴⁵ See Kevin Lang & Russell Weinstein, *Evaluating Student Outcomes at For-Profit Colleges*, Nat'l Bureau of Econ. Research (2012), <http://www.nber.org/papers/w18201.pdf>.

⁴⁶ HELP Report at 8.

⁴⁷ *Id.* at 114.

⁴⁸ *Id.* at 117–18 (recounting the recent history of private student loans in for-profit education); *see generally* Consumer Financial Protection Bureau, *Private Student Loans* (2012), <https://perma.cc/L273-8PKJ>.

⁴⁹ See, e.g., *ITT Trustee to Stop Collection on All “Temporary Credit Accounts*, Project on Predatory Student Lending (May. 19, 2017), <https://perma.cc/9DTQ-445A> (describing the problem of institutional debts for former ITT students).

⁵⁰ 34 C.F.R. § 668.28.

misconduct that would give rise to borrower defense cancellation.⁵¹ Thus, Treasury should ensure that any extension of the above exceptions applies equally to cancellation of non-federal education debts.

In light of the widespread misrepresentations and related legal infirmities committed by for-profit schools as well as the likelihood that former students are insolvent, we urge Treasury to extend the logic of Revenue Procedures 2015-17 and 2017-24 to all cancellations of student indebtedness that result from school misconduct by for-profit colleges, and to all forms of debt.

Recommendations

The 36-Month Rule and cancellation of student loans illustrate that creditors sometimes possess vital information about the nature of the transaction that is not reflected on the Form 1099-C they are required to issue. Easing the burdens on the issuer of the Form 1099-C at the cost of allocating additional burden to the taxpayer and the IRS to determine their specific tax treatment creates inefficiencies that are unnecessary and costly. Further, information returns that willfully ignore the underlying tax reality do little to assist the IRS in its compliance missions. The following recommendations draw on the lessons of the 36-Month Rule, as well as student loan debt cancellation, to provide potential fixes that consider the interests of taxpayers, information return issuers, and the IRS.

- Regulatory Change: Amend Treasury Regulation § 1.6050P-1(a)(3)

The current Regulations for when Form 1099-C must be issued place undue emphasis on the “identifiable events” leading to issuance. This is particularly evident in the proviso that a creditor must issue Form 1099-C “regardless of whether the debtor is subject to tax on the discharged

⁵¹ For instance, private loans must contain the Federal Trade Commissions “Holder Rule” language. 16 C.F.R. § 433.2. This language served as a model for the Department of Education’s borrower defense loan cancellation provisions. It permits private loan borrower to seek cancellation of debts for the same reasons. Similarly, institutional debts may be subject to cancellation in litigation or negotiation with schools. Cf. *ITT Trustee to Stop Collection on All “Temporary Credit Accounts*, Project on Predatory Student Lending (May. 19, 2017), <https://perma.cc/9DTQ-445A>.

debt under sections 61, 108 or otherwise by applicable law.” Where the creditor *knows* that the debt *must* be non-taxable because the reason for discharge is non-taxable it is non-sensical to require an information return.

The Public Service Loan Forgiveness (PSLF) Program created by the College Cost Reduction and Access Act of 2007 provides a relevant example of a loan forgiveness that any change in the regulation needs to address. PSLF enables indebted individuals to qualify for the forgiveness of certain federal student loans by working for a qualifying public or non-profit entity for 10 years (i.e., after making 120 “qualifying monthly payments”).⁵²

On September 1, 2017, it was reported that “at least 600,000 people have expressed interest in receiving debt relief” under the PSLF Program.⁵³ The form for borrowers to apply for forgiveness was released in September of 2017. Given that the first qualifying monthly payments were made in October of 2007, it is likely that borrowers will start to receive loan forgiveness in November of 2017.

Discharges under the PSLF Program should qualify for relief under IRC § 108(f). This is because the loans in question were made by an instrumentality or agency of the United States, and the discharge is pursuant to a provision under which an individual’s indebtedness would be forgiven if the individual worked for a period of time in certain professions.⁵⁴

However, unless the Regulations in respect of IRC § 6050P are amended, we expect each borrower receiving loan forgiveness under the PSLF Program will also receive a Form 1099-C. This is because the existing Regulations impose reporting obligations on applicable entities in

⁵² The PSLF Program provides for the forgiveness of the remaining balance on a borrower’s Direct Loan (i.e., a loan received under the William D. Ford Federal Direct Loan Program) after the borrower has made 120 qualifying monthly payments under a qualifying repayment plan while working full-time for a qualifying employer.

⁵³ Katie Lobosco, CNN Money, ‘Government, nonprofit workers can now apply for student loan forgiveness’ (September 1, 2017) <<http://money.cnn.com/2017/09/01/pf/college/public-service-loan-forgiveness-application/index.html>>.

⁵⁴ Consistent with this conclusion, the website of Federal Student Aid (<https://studentaid.ed.gov/sa/repay-loans/forgiveness-cancellation/public-service>) states: “Note that loan amounts forgiven under the PSLF Program are not considered income by the Internal Revenue Service. Therefore, you will not have to pay federal income tax on the amount of your Direct Loans that is forgiven after you have made the 120 qualifying payments.”

respect of any discharge of a debt obligation over the \$600 threshold amount, regardless of whether the debtor is subject to tax on the amount of income.⁵⁵ The Department of Education is an “applicable entity”⁵⁶ for the purposes of IRC § 6050P, and it is therefore subject to the information reporting requirements under that section. Further, in the vast majority of cases, the \$600 threshold amount will be breached.

If Forms 1099-C are issued in such circumstances, this will generate an enormous amount of unnecessary paperwork, with no benefit to the IRS. It will also the potential for considerable confusion. The taxpayer should not be required to report the tax in any way on their return: all the information return accomplishes in that situation is to increase the chance that the taxpayer erroneously includes income they shouldn’t, or that the IRS audits (or otherwise devotes resources examining) a return that correctly fails to include non-taxable income. There is nothing in the enabling code section, IRC § 6050P, that requires issuance of Form 1099-C when the discharge is non-taxable. In fact, the statute appears to give the Treasury leeway in determining how and when an information return is required under the statute.⁵⁷ Presently, however, it is clear that the IRS would generally expect a creditor to issue Form 1099-C even for an explicitly non-taxable discharge of debt.⁵⁸

A taxpayer should not be required to guess if the discharge of indebtedness is taxable based on information they can’t possibly know, and that is possessed by the creditor. But where the reason for discharge necessarily results in non-taxable income, the regulation should be amended to read that Form 1099-C is not required. This does not adversely effect creditors: it should not lead to difficult determinations of taxability.

- Sub-Regulatory Change: Expanded Use of Revenue Procedures (Rev. Procs.) to Abate Requirement of Form 1099-C Issuance

⁵⁵ Reg. § 1.6050P-(a)(3).

⁵⁶ Under limb (A) of the definition in IRC § 6050P(c)(1).

⁵⁷ See IRC § 6050P(a) explicitly giving the Secretary control via regulations over the “time and form” required for an entity discharging debt. It already appears to be the IRS position that some discharges need not be reported on Form 1099-C, per Rev. Proc. 2014.

⁵⁸ See IRS Notice 2009-0126 (accessed here: <https://www.irs.gov/pub/irs-wd/09-0126.pdf>). Note that this explicitly pertains to student loans that were cancelled because of the public service requirements of 20 USC 1087ee and are explicitly non-taxable under IRC 108(f).

Where large classes of similarly situated taxpayers have debt discharged that likely does not result in taxable income, a cost-benefit analysis counsels against requiring issuance of Form 1099-C. The IRS, notably through Rev. Proc. 2017-24, has taken steps towards this treatment with certain cancelled for-profit college student loans. The IRS should be encouraged to expand this treatment to similar situations and perhaps find a way to create a streamlined basis for issuing such rulings.

Solutions that only focus on pronouncements of the tax treatment of the item, and not the Form 1099-C issuance, do not address the issue at its most efficient stage. The IRS can (potentially) ameliorate the problem on the back-end by assigning values to these Form 1099-Cs such that they do not trigger the AUR function when they are left off a return. However, this only addresses one-half of the equation: it is unclear that the IRS would be able to identify taxpayers that erroneously *do* include the cancelled debt as income. Undoing these mistakes, once made, are time consuming. And to the extent that they are not undone, they vitiate the taxpayer's right to be informed and the right to pay no more tax than is due.⁵⁹ Stopping the confusion at its source (the Form 1099-C issuance) is the most effective method.

This approach lessens back-end work from the IRS in ensuring that 1099-Cs do not trigger AUR activities. It also prevents taxpayer confusion on receiving a form that they may erroneously believe they must include in income. Finally, this approach has the additional benefit to creditors of providing specific guidance to them on the transactions at issue. It is, in effect, a "free" Private Letter Ruling for the entity; however, the value to the taxpayers and the IRS in avoiding the downstream costs makes the issuance of such rulings extremely cost effective even if the IRS is not collecting a fee.

Sub-Regulatory Change: Amend Form 1099-C's "Instructions for Debtor" as follows

⁵⁹ See IRC § 7803(a)(3)(A) and (C)

“However, you may not have to include all of the canceled debt in your income. There are exceptions and exclusions, such as bankruptcy, insolvency, and certain student loans. See Pub. 4681, available at IRS.gov, for more details.”

In sum, we believe that the above recommendations adequately account for the interests of taxpayers, creditors/information return issuers, and the mission and resources of the IRS. They protect taxpayers against paying more tax than is due, or being subject to unnecessary audit. They provide clarity to creditors on when they must issue an information return, and a safeguard for when they do not so issue. Finally, the recommendations help conserve and better concentrate the resources of the IRS through enhancing the “quality, utility, and clarity of the information” that is to be collected and used for compliance.

Keith Fogg

Director of Harvard Law School Federal Tax Clinic
122 Boylston St
Jamaica Plain, MA 02130