

**REPORTING DISCHARGE OF INDEBTEDNESS TO THE
INTERNAL REVENUE SERVICE (IRS)**

- 1. REASON FOR ISSUE:** To revise Department of Veterans Affairs (VA) debt management procedures formerly contained in VA Manual MP-4, part VIII, chapter 26, Reporting Discharge of Indebtedness to the IRS.
- 2. SUMMARY OF CONTENTS/MAJOR CHANGES:** This handbook establishes the procedural guidelines for reporting discharge of indebtedness to the IRS.
- 3. RESPONSIBLE OFFICE:** Cash and Debt Management Division (047GC1), Office of the Deputy Assistant Secretary for Finance.
- 4. RELATED DIRECTIVE:** VA Directive 4800, Debt Management.
- 5. RESCISSIONS:** VA Manual MP-4, Part VIII, Chapter 26, dated September 22, 1992.

CERTIFIED BY:

**BY DIRECTION OF THE SECRETARY
OF VETERANS AFFAIRS**

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REPORTING DISCHARGE OF INDEBTEDNESS TO THE INTERNAL REVENUE SERVICE

1. PURPOSE AND SCOPE. This handbook establishes standardized Department-wide procedures for reporting discharge of indebtedness to the Internal Revenue Service (IRS). This handbook does not apply to benefit debts.

2. RESPONSIBILITY. The Chief of the Fiscal Activity must ensure appropriate procedures are followed in accordance with this handbook for reporting discharge of indebtedness to the IRS. Any reference in this handbook to the Chief of the Fiscal Activity also includes the Director of the Debt Management Center (DMC) where appropriate.

3. DEFINITION OF TERMS

a. **Termination.** A decision by the government to stop all collection activity on an account, but to hold the account for possible future collection action. This decision is made when it is determined that further collection activity will be fruitless or not cost effective at the time, but may be warranted at some future date. Terminated debts may be reactivated and collected if they have been written off but not closed out.

b. **Write-off.** "Write-off" is often used interchangeably with "termination." However, "termination" is a legal procedure, while "write-off" is an accounting procedure generally associated with removing the debt from agency records.

c. **Close-out.** Upon determining that additional future collection efforts on a debt would be futile, an agency reports the amount of a terminated debt to the IRS as potential income to the debtor on Form 1099C, Cancellation of Debt. For debts that are not reportable to IRS, such as VA benefit and home loan debts, close-out never actually occurs.

d. **Currently not collectible (CNC).** A classification that follows write-off if the agency decides that debt collection efforts should continue. While this designation may be used for any debts, the primary use of this designation is for those debts that VA has terminated, and thus removed from the Department's financial records, but that have been referred to the Department of the Treasury (Treasury) for the Treasury Offset Program (TOP) and/or for cross-servicing.

e. **Discharge.** In accordance with 31 CFR 903.5, a "discharge" of a debt is the same as a "close-out" of the debt, as described in paragraph 3.c.

4. LEGAL AND REGULATORY AUTHORITY. 26 U.S.C. 61(a)(12) and 6050P, 26 CFR 1.6050P-1, and 31 CFR 903.5 state that any financial institution (as defined in 26 U.S.C. 6050P(c)(1)) that discharges an indebtedness of any person

of at least \$600 during a calendar year must file an information return on Form 1099-C with the IRS.

5. GENERAL

The Department of Veterans Affairs does not make determinations regarding a taxpayer's responsibility to declare discharged indebtedness for tax purposes. The basic responsibility for such reporting is the taxpayer's and arises from IRS Code (26 U.S.C. 61(a)(12)), which defines discharge of indebtedness as income. However, VA and other federal departments and agencies are required to provide information to the IRS on certain discharged or forgiven debts where the amount is in excess of \$600. Income from the discharge of an indebtedness arises in the calendar year in which an obligation is either closed out, is satisfied at less than face value (compromised), or is forgiven (waiver). Field stations/facilities must report to the IRS certain nonbenefit debts under their jurisdiction which meet the following criteria for "discharged indebtedness."

- a. The debtor must be an individual.
- b. The debt is determined to be uncollectible and is written off, waiver is granted, or some form of formal compromise agreement is reached.
- c. The amount of the debt is \$600 or more (amount includes principal, administrative costs, and interest).
- d. The obligation is not discharged in bankruptcy.

6. FORMS TO BE USED WHEN REPORTING DISCHARGED DEBTS TO THE IRS

- a. Department of the Treasury Form 1099C (formerly called the 1099G), Statement for Recipients of Certain Government Payments, will be used to report discharge of indebtedness information to the IRS on a calendar year basis.
- b. Department of the Treasury Form 1096, Annual Summary and Transmittal of United States Information Returns, will be used to transmit accumulated Forms 1099C to the IRS.

7. INDEBTEDNESS REPORTABLE AND NOT REPORTABLE TO THE IRS

- a. The following types of debts are reportable to the IRS when written off:
 - (1) The discharge of a debt against a transferee or vendee debtor; and
 - (2) The discharge of a debt of an ineligible hospitalization or humanitarian or emergency care.

b. The following types of debts **are not** reportable to the IRS when written off:

(1) Debts as a result of participation in a VA benefit or home loan program;

(2) Medical care and pharmacy copayments;

(3) Debts, where the payment of funds has already been reported to the IRS for income tax purposes, i.e., salary or payments that are reported on IRS Form 1099 MISC;

(4) Discharge of indebtedness due to death; and

(5) Debts which are in dispute and are written off.

8. COMPLETION OF FORM 1099C. Current instructions for completion of the Form 1099C can be found at <http://www.irs.gov/instructions/i1099ac/index.html>.

9. TRANSMITTAL OF FORMS 1096 AND 1099C TO THE IRS

a. Form 1096 will be used to transmit Form 1099C to the IRS. Form 1096, along with copy "A" of Form 1099C, must be mailed to the IRS by February 28 of each year.

b. General instructions for completion of Form 1096 can be found at <http://www.irs.gov/instructions/i1099ac/index.html>. In the "Search Forms & Publications" box located on the top left side of the screen, type "1096," hit "go," and you will be directed to the 1096 form and instructions (Adobe format). To order forms, call 1-800-829-3676.

10. TREASURY REPORT ON RECEIVABLES 1099C REPORTING

REQUIREMENT. Treasury's revised "Report on Receivables Due from the Public" requires reporting on discharged debts where 1099Cs have been issued. Beginning with fourth quarter FY 2004 reporting, all field stations will maintain a record of debts where 1099Cs have been issued and will prepare a report, which is due in VACO (047GC1) 22 days after the second quarter ends (example, the second quarter ends March 30, the report is due April 22). Required data on the report should include the (1) date of the 1099C issuance, (2) dollar amount, and (3) appropriation. The reports should be e-mailed to VACOTROR or faxed to the Cash and Debt Management Division (047GC1) at (202) 273-6574. Negative replies are not required.

11. INSTRUCTIONS. Fiscal activities are to contact local IRS offices in December or January of each year to obtain current instructions on completing Forms 1096 and 1099C.