

Office of Chief Counsel
Internal Revenue Service

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memorandum

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date: February 4, 1999

to: District Counsel, Pennsylvania District. Philadelphia
CC:NER:PEN:PHI

from: Assistant Chief Counsel (Income Tax & Accounting) CC:DOM:IT&A

subject: Significant Service Center Advice Request
Underreporter Assessments

This responds to your request for Significant Advice, dated October 28, 1998, concerning the allocation of income resulting from a discharge of indebtedness.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in CCDM (35)2(13)3:(4)(d) and (35)2(13)4:(1)(e). This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

Issue

To whom should income from discharge of the joint indebtedness of husband and wife be allocated on separately filed returns for the year in which the debt was discharged.

Conclusion

Both co-obligors, husband and wife, received income in the total amount of the debt discharged. However, a determination should be made as to the appropriate amount of discharged debt allocable to each taxpayer that is jointly and severally liable, taking into account all the facts and circumstances.

Facts

Two taxpayers, husband and wife, created a debt in 1994 for which they were jointly and severally liable. The debt was discharged

in 1996. The debt discharge was reported to the Service on a Form 1099C on which both taxpayers and the husband's social security number were listed. The taxpayers filed separately for 1996.

Discussion

Section 6050P of the Internal Revenue Code requires certain entities to report discharges of indebtedness. Final regulations issued under § 6050P address the treatment of joint obligors. In general, a reporting entity must report discharges of indebtedness for each debtor discharged from such indebtedness. § 1.6050P-1(e)(1)(i). Only one report is required in the case of husband and wife co-obligors living at the same address when the indebtedness was incurred, provided that the reporting entity does not have reason to know that such circumstances have changed at the date of the discharge. Id. In addition, in the case of multiple debtors that are jointly and severally liable on an indebtedness, the amount of discharged indebtedness required to be reported with respect to each debtor is the total amount of the indebtedness discharged. § 1.6050P-1(e)(1)(ii). When the reporting requirement of § 6050P was enacted, Congress indicated in the legislative history that it did not expect the reporting institutions to determine whether the debtor has income from the discharge of indebtedness. H.R. Conf. Rep. No. 213, 103^d Cong. 1st Sess. 1, 671 (1993). Accordingly, multiple reporting of the discharged debt is consistent with § 6050P(a)(1) which requires reporting for each person whose indebtedness was discharged.

A joint and several obligation creates a legal relationship between the creditor and the co-obligors under which the creditor may sue one or more of the parties to the liability separately, or all of them together at the creditor's option. Black's Law Dictionary 751 (5th ed. 1979). At common law, an obligor who is required to satisfy more than that obligor's proportionate share of a common obligation generally is entitled, under state law, to seek pro rata contribution from each of the other co-obligors. Restatement of Restitution §§ 81, 85 (1936). However, the right of contribution is an equitable doctrine, and depends upon a determination of the facts and circumstances, including whether the co-obligors equally enjoyed the use of the proceeds of the indebtedness. Relevant factors may include, for example, which of the co-obligors received the debt proceeds, was allocated the basis attributable to property purchased with the debt, and claimed interest deductions arising from the debt. State property law also may indicate how an allocation is to be made. See, e.g., Brickman v. Commissioner, T.C. Memo. 1998-340 (holding that because partnership interest was community property, one-half of the discharge of indebtedness income received by the partner-spouse in a community property state must be allocated to the nonpartner spouse). Such an analysis is analogous to that

made in determining a spouse's share of a joint net operating loss. Section 1.172-3(d)(1) of the Income Tax Regulations states that a spouse's share of the joint net operating loss is that portion of the joint net operating loss attributable to that spouse's gross income and deductions to the extent taken into account in computing the joint net operating loss.

Because a taxpayer has a pro rata right of contribution from each of the co-obligors under certain circumstances, discharge of all of the co-obligors of the full amount of a joint and several obligation by a creditor should not be treated as income to each co-obligor in the full amount of the discharged obligation under § 61(a)(12). See Kahle v. Commissioner, T.C. Memo. 1997-91 (suggesting that the amount of cancellation of indebtedness income to a debtor in bankruptcy that gives rise to attribute reduction may be reduced because certain of the discharged debts were joint liabilities); Bressi v. Commissioner, T.C. Memo. 1991-651 (finding that the amount of discharge of indebtedness income for two taxpayers with joint and several liability for indebtedness was equal to the total amount of indebtedness discharged); Rev. Rul. 92-97, 1992-2 C.B. 124 (determining that the amount of discharge of indebtedness income for a partnership and two jointly and severally liable partners is equal to the total amount of indebtedness discharged). Rather, an appropriate allocation of the discharged indebtedness should be made between the co-obligors, based on all the facts and circumstances.

Accordingly, if the allocation can be made with certainty, we recommend issuing a notice or notices of deficiency in accordance with the allocation. In a case in which it is not possible to make an appropriate allocation, we recommend issuing notices of deficiency to both spouses for the full amount of the discharged liability.

If you have any questions or comments regarding this matter, please call Amy Pfalzgraf at (202) 622-4930.

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By: _____
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