

1099 Cancellation of Debt - Liquidated Damages?

I have a client who signed up for a MLM but got out before she completed the "trainings". Contract specifies a \$7,500 cancellation penalty, but no other money was exchanged in either direction. Client has now been issued a

1099 for a damages clause I would think is unenforceable. short of going to tax court, I can't see anyway to contest this charge. They have the

unilateral ability to cause a tax liability for my client? Any input would be much appreciated.

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This may be relevant

<https://www.jdsupra.com/legalnews/1099-c-discharge-without-debt-1762451/>

Ronald Jones, Florida

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Would client qualify for the insolvency exception?

<https://www.irs.gov/pub/irs-pdf/p4681.pdf>

Corrine Bielejeski, California

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That's my current game plan, but I think it's bunk that they can just mail her a tax obligation with no burden of proof.

John Strong

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Actually, I have considered filing a class action on this issue. There is no cancellation of debt if there is a bona fide dispute over whether a debt exists. A lawsuit would have to be filed against the MLM company to void the "debt" and then the issue can be sorted out with the IRS with that court judgment. You can message me offline to discuss if you like.

Jeffrey Wilens, California

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Another thing is they can't try to collect on the debt if they are issuing a 1099, because the debt has to be forgiven and thus not collectible.

<https://attorney-newyork.com/knowledge/debt-faqs/am-i-responsible-for-paying-debt-if-i-receive-a-1099c-on-it/>

Also, in that link there is a link to file a dispute with the IRS and it does look like you can appeal the validity of the 1099

<https://www.irs.gov/appeals>

Erin M. Schmidt, Ohio

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A 1099 does NOT make debt uncollectible. Even your link states However, in 2016, an IRS rule allowed debt collectors to file a 1099-C after 36 months of no payment. In this event, the account is still delinquent, but the debt hasn't been forgiven, so the lender may still try to collect.

Nicholas I. Fuerst, Arizona

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The best recourse is to sue the creditor that filed a bogus 1099-C. If a court rules the debt is not valid then it cannot qualify as cancelled debt for tax purposes. Plus, you may be entitled to damages and it might be possible to bring the claim as a class action.

Jeffrey Wilens

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Keep reading Nicholas.

They amended the rule a year later today it didn't have to be issued and should only been issued when the debt is forgiven.

Collecting on the debt means the debt isn't forgiven and the collector needs to either recall the 1099 or you need to dispute it.

Which is exactly what that page goes on to tell you.

But, if you believe that forgiven debt can be collected on, please explain what the definition of forgiven you are using.

Erin Schmidt

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See

[https://scholar.google.com/scholar\\_case?case=11672474246137466273&q=Gericke+v.+Truist&hl=en&as\\_sdt=8000006&as\\_vis=1](https://scholar.google.com/scholar_case?case=11672474246137466273&q=Gericke+v.+Truist&hl=en&as_sdt=8000006&as_vis=1)

JOHN GERICKE, individually and on behalf of all individuals similarly situated, Plaintiff, v. TRUIST, et al., Defendants.

United States District Court, D. New Jersey, Camden Vicinage.

March 26, 2021.

Which deals with this issue, "discharge" vs "actual discharge"

Case law supports this conclusion, as well. For instance, the court in Wells Fargo Bank, N.A. v. Frazee, like here, analyzed the impact of a Form 1099-C issued pursuant to subsection "G." No. 19-10499-GAO, 2020 WL 1615866, at \*2 (D. Mass. Apr. 2, 2020). The court wrote that the Form 1099-C was filed to conform with IRS regulations, in satisfaction of a reporting requirement for tax purposes that arose regardless of whether "an actual discharge of indebtedness [had] occurred." There is no other evidence offered that [the defendant] "actually" cancelled or discharged [the plaintiff's] debt. This view comports with a majority of courts that have considered the significance of the filing of Form 1099-C and have held that the Form 1099-C itself does not operate to legally discharge or otherwise cancel the underlying debt, but rather is simply the fulfillment of a reporting requirement to the IRS.

Ronald Jones

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The cited case does not address the original poster's issue I believe. My reading was that he contended the \$7500 "cancellation fee" was likely bogus and therefore no debt existed in the first place. Seems that would be the easiest most straightforward approach to obtaining relief. If the debt is invalid then the discussion below about whether cancellation of debt is taxable or not.

Jeffrey Wilens

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<https://www.irs.gov/forms-pubs/about-publication-4681>

<https://www.irs.gov/forms-pubs/about-form-1099-c>

<https://www.irs.gov/taxtopics/tc431>

Client could also sue MLM for declaratory judgment, damages, fraud, misrepresentation, and potentially debt collection violations. In the instance related, there has been no clear incurrence of

debt or adjudication of same. I know some CPAs who will show the income reported and that the claim is disputed, but did not clearly see in a brief review of the links how that was a superior approach.

Darrell G. Stewart, Texas

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Thank you all for the input. I have a gameplan moving forward.

Original Poster