RS

UNITED STATES TAX COURT

WASHINGTON, DC 20217

Benjamin Cornell Bridges, Petitioner	)	
v.	)	Docket No. 228-15
COMMISSIONER OF INTERNAL REVENUE, Respondent	)	

O R D E R

Pursuant to Rule 152(b), Tax Court Rules of Practice and Procedure, it is

ORDERED that the Clerk of the Court shall transmit herewith to petitioner and to respondent a copy of the pages of the transcript of the trial in the above case before Judge Mark V. Holmes at El Paso, Texas, on October 31, 2016, containing his oral findings of fact and opinion rendered at the trial session at which the case was heard.

In accordance with the oral findings of fact and opinion, a decision for petitioner will be entered.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
November 10, 2016

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Bench Opinion by Judge Mark V. Holmes
October 31, 2016
Benjamin Cornell Bridges v. Commissioner
Docket No. 228-15

In the case of Benjamin Cornell Bridges v. Commissioner, Docket Number 228-15, the Court has decided to render oral findings of fact and opinion, and the following is the Court's oral findings of fact and opinion.

This bench opinion is made pursuant to the authority granted by Section 7459(b) of the Internal Revenue Code of 1986, as amended, and Rule 152 of the Tax Court's Rules of Practice and Procedure.

This is a one-issue case, and the one issue is whether Mr. Bridges received $5,238.80 in income that he did not report on his 2013 income tax return. The parties were able to reach a stipulation, and together with the testimony, the record of the case is complete.

Mr. Bridges was a resident of Texas when he filed his petition and remains so today.

I want to begin with some background here. Mr. Bridges I found to be an entirely credible witness. He was very patient here. He was here all day and in the courthouse from beginning to end of

the very long day, and he can tell his wife that, for sure.

I also want to stress that he is an honorable man. He volunteered to serve in the Army; he was discharged honorably. He served as a contract employee in our current wars, as a civilian where he was exposed to peril even in that capacity.

This case arises from the dishonorable behavior of his ex-wife. Many years ago they separated, and they were divorced when he was overseas.

But before they separated, they had both signed the loan papers and finance agreement for a 1998 Ford Expedition. I believe him when he says it was her idea and that he wanted to have this vehicle for her use. But the debt was his, too.

Both he and his ex-wife signed the various papers that can be found in Exhibit 4-J. In the divorce, though, she got the vehicle, and she was ordered to pay any associated unpaid debts with that vehicle.

She did not. Shortly after the divorce became final, the vehicle was repossessed almost immediately. It was sold at auction after being repossessed, and the auction price was less than the

outstanding amount of the loan. This gives rise to something called a deficiency: the difference between what the auction price was and the amount that was outstanding on the loan.

This deficiency is a debt that was owed by both Mr. and Mrs. Bridges, and it went to several different collection agencies, and over the course of seven years, the debt proved uncollectible.

Finally it was returned to GM, where it was written off, then generating a reporting obligation ~~by~~ on the part of GM which it discharged by sending a 1099C to Mr. Bridges.

Now, those facts aren't really much in dispute here. The question is what does the law have to say about this? And it turns out to be complicated, thus the lengthy time I was back there, Mr. Bridges.

First off, the Code is pretty obvious. It says -- Section 61(a)(12) -- that included in gross income is income from the discharge of indebtedness. So there was clearly a discharge of indebtedness here, and that generates at least a presumption of income.

Now, for the IRS, this is an easy case. There is a precedent, Jensen v. Commission, T.C. Memo

2010-77, 99 TCM 1334 (2010), which seems to be very, very similar to what Mr. Bridges' situation is. In Jensen, Jensen and his wife entered into a divorce agreement under which the wife agreed to assume a debt that Jensen had created.

The IRS claimed that before the divorce Citibank -- in that case that was the source of the money -- had made a loan to Jensen, and Jensen was liable for the debt.

Jensen was the original borrower, and so my Court ruled that under the 2004 divorce agreement that said the debt was now owed by Mrs. Jensen, not Mr. Jensen, that didn't make a difference.

Under state law we concluded "the divorce agreement gave Jensen a right of indemnification against his wife. The agreement did not relieve Jensen of liability to Citibank. Thus Jensen was still liable for the debt when Citibank forgave the debt from 2005."

We therefore held against Mr. Jensen in that case, but, but, but what makes this case complicated is that the original obligor on the Jensen debt was Mr. Jensen, not his ex-wife. In this case both Mr. Bridges and the then-Mrs. Bridges signed the paperwork. They were co-obligors, because

they both owed the obligation on the Ford Expedition.

What effect does this have? Here's where things get complicated. It's clear, as I said, that both Mr. and Mrs. Bridges were co-buyers; see page 4 of Exhibit 4-J. They were both listed on the account; see pages 18 through 20 of Exhibit 4-J. And interestingly enough, they both received the deficiency calculation with its completely accurate notice that, after the vehicle was sold at auction and there was still a part of the loan to be repaid, they were both on the hook for that deficiency, as it's called, under Texas law.

Well, fast-forward seven years, and that deficiency is being forgiven by the lender. What effect does this have? Well, the lender also behaved in the way he should behave. He sent out a notice.

Section 6050P of the Internal Revenue Code requires certain entities to report discharges of indebtedness. Under the regs for that section, 26 CFR Section 1.6050P-1(e)(1)(I), "In the case indebtedness incurred prior to January 1, 1995, and indebtedness of less than $10,000 incurred on or after January 1, 1995, involving multiple debtors, reporting under this section is required only with respect to the primary or first-named debtor.

"Additionally, only one return of information is required under this section if the reporting entity knows or has reason to know to know that co-obligors were husband and wife living at the same address when an indebtedness was incurred and does not know or have reason to know that such circumstances have changed at the date of the discharge of the indebtedness."

It goes on to say, in (ii), "In the case of multiple debtors jointly and severally liable on an indebtedness, the amount of discharged indebtedness required to be reported under this section with respect to each debtor is the total amount of indebtedness discharged."

This makes things a little bit more complicated, because what this says is that for a debt in the amount of less than $10,000, which this debt was, the reporting obligation for the 1099C is simply to send it to the person who is named first on the loan, which is exactly what the lender did here.

However, there's an exception when circumstances have changed. And here circumstances did change. The lender should have known, since it sent the deficiency calculation to the ex-Mrs. Bridges at that point to a different address, that

there were two different addresses. Instead, so far as the record shows, they didn't understand that an exception to the general rule applies and instead sent the notice right to Mr. Bridges.

What to do now? Well, it's clear that the reporting requirement of Section 6050P is not the same as saying that it is the income that Mr. Bridges has.

Congress indicated in the legislative history that it did not expect the reporting institution to determine whether the debtor had income from the discharge of indebtedness. See H.R. Conf. Rep. No. 213, 103rd Congress 1st Session 1,671 (1993).

So the reporting obligation, the fact that you got a 1099C, Mr. Bridges, isn't the end of the story here. The 1099 was accurate, and it was sent to you, which was legal, maybe only maybe because, as I said, it appears the lender knew that your ex-wife had a different address at the time of the repossession and auction of the car.

So what we have here is a joint and several obligation that has been discharged. What to do with this? Well, the analysis in the IRS Chief Counsel Advice Memo 200023001 is, although not binding on me,

certainly helpful in getting me to understand the somewhat complicated law in this area.

Let's begin with some simple things. 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 for the liability separately, or all of them together, at his option.

At common law, an obligor who is required to satisfy more than that obligor's proportionate share of the common obligation generally is entitled, under state law, to seek pro rata contribution from each of the other obligors.

In other words, Mr. Bridges, if you had been sued for the deficiency after the vehicle was auctioned, you could have gone after your wife for her contribution, at least for 50/50. However, the right depends on the 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. In other words, property rights matter. Who owned the car after the divorce matters.

How do we determine this? We look to state property law, and state property law may indicate how an allocation is to be made.

Because a taxpayer has a pro rata share right of contribution from each of his co-obligors under certain circumstances, discharged of all of the co-obligors of the full amount of the joint and several obligation by creditor should not be treated as income to each co-obligor in the full amount of the discharged obligation under 61(a)(12). See CCA Number 200023001 at page 3 (and citations omitted).

Rather, says the IRS, an appropriate allocation of the discharged indebtedness should be made between the co-obligors, based on all the facts and circumstances. And this makes sense.

Let's assume that the car company sent a 1099C to both Mr. Bridges and the former Mrs. Bridges. If it had done so, it was discharging a debt of $5,800 or so, but both of them would not have taken and had to include $5,800 in their income as cancellation-of-indebtedness income, because then you'd be having $11,600 of cancellation-of-

indebtedness income and not the actual amount, which was 5800 or so.

So how to make the allocation? I think the allocation should be made under the law according to the facts and circumstances of each case.

Crucially, of course, Texas is a community-property state, and we have a case called Brickman v. Commissioner, T.C. Memo 1998-340, 76 TCM 506 (1998), in which cancellation of debt income was to a partnership.

Now, the husband in that case was one of the partners in the partnership, so the cancellation-of-debt income went to the partnership as a whole, and since he was one of the partners, it flowed through to him, at least according to his pro rata share.

But Texas is a community-property state, we said in Brickman, and so that meant that half the partnership income flowed through to this wife. So in the case of Mr. Brickman, if you looked just at the partnership, he got his share of the partnership's cancellation-of-debt income, had to pay tax on it, but because he was married and Texas is a community-property state, only half of that belonged to him.

Now, what we said in Brickman was "As we have found, the COD income" -- that's cancellation-of-debt income -- "was an item of partnership income that passed through the partners. We now turn to state law to ascertain who owned this income.

"Texas is a community-property state. Generally spouses residing in a community-property state are liable for the federal income tax on one-half of their community income. Income and deductions attributable to community property are also Petitioners' community property. Petitioners stipulated that the partnership interest was community property.

"Under Texas law therefore income and deductions attributable to the partnership interest are Petitioners' community property. We conclude that Susan" -- that is, Mrs. Brickman -- "had a community interest in the COD income of the partnership that flowed through to James" -- that was Mr. Brickman. "In other words, she owned one-half of the cancellation-of-debt income."

So instead of having a partnership, what we had here was a Ford Expedition. That Ford Expedition, when Mr. Bridges and Mrs. Bridges purchased it together, was community property. The

debt that they owed was a community debt. This was under state law, which, according to Brickman, is the law that I have to look at here.

What happened to that debt after the divorce? Well, for that again I looked at state law, which in this case is the state court divorce decree, and it says quite clearly, as Mr. Bridges emphatically put it, that the debt was hers, the car was hers -- I'm sorry -- the vehicle was hers. If she had had the right to take interest deductions, they would have belonged to her. If somehow she had souped the Ford Expedition up and it had become more valuable rather than less valuable and she had sold it, she would have been entitled to the profits; she would have had to pay the capital gains tax on it.

And so here the income that's attributable to the Ford Expedition, as a matter of state law, I find is entirely the former Mrs. Bridges', and Mr. Bridges owes no deficiency. Oddly enough, representing himself, he has won. Decision will be entered for Petitioner.

Thank you, Mr. Bridges. We'll get a copy of the transcript to you in due course.

(Whereupon, at 6:13 p.m., the above-entitled matter was concluded.)