Channels of Tax Law (Mis)Information

Taxpayers receive information about tax law from a variety of sources – not only from tax advisors or the IRS. Some of the information is dispensed when a taxpayer is deciding not how to file a tax return but whether to engage in a transaction. Lawyers and tax advisors should be aware of the potential sources of information and misinformation that individuals might encounter before or while filing tax returns.

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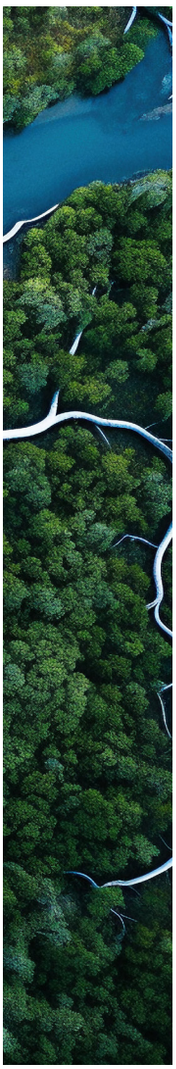

With tax-return-filing deadlines upon us, many people will turn to paid professionals for assistance in preparing tax returns or use filing software. Some will visit the IRS's website or make use of other sources of IRS or Wisconsin Department of Revenue guidance.

At various points in time – during the tax-return-filing season and beyond – we also encounter tax law information dispensed by a multitude of different sources. For example, sellers of commercial products and services display tax law information on their websites with varying degrees of accuracy. Debt collectors include information about the tax consequences of nonpayment in debt collection letters. Numerous other actors, including charitable organizations, employers, schools, and health-care providers, also share tax law information.

In some instances, these actors provide accurate and potentially helpful information. For example, a Boston pediatricians' office provides parents and guardians with information about tax filing and provides tax filing assistance on site.[2] For some taxpayers, tax filing can offer key economic benefits – including receipt of the earned income tax credit and receipt of the child tax credit. The Boston pediatricians' office surveyed clients who used the on-site tax filing service, and, of the 244 clients who responded to the survey, 21% had not previously filed tax returns and 14% reported receiving the earned income tax credit for the first time.[3]

In other instances, these actors provide information that is inaccurate or potentially misleading. In some cases, inaccuracy stems from the ever-changing nature of tax law. Information on a website can quickly become outdated as the specific parameters of tax provisions change. For example, a drugstore might include information on a website that refers to an outdated dollar limit on the amount of health flexible spending account (FSA) funds that can, potentially, be carried forward from one year to the next.[4]

Example: Banks & Deductibility of Home Mortgage Interest

In some situations, businesses exaggerate the likelihood of potential customers securing tax benefits. For example, a bank might make available for "educational purposes" an online article that informs readers that home mortgage interest is tax deductible "in most cases."[5] Subject to various dollar limitations and requirements, homeowners can claim a U.S. federal income tax deduction for home mortgage interest but only if they itemize deductions rather than claim the standard deduction.[6] If a taxpayer claims the standard deduction, then they deduct a flat dollar amount, adjusted annually for inflation.[7] If, instead, the taxpayer opts to itemize deductions, the taxpayer will deduct an amount equal to certain actual expenses incurred by the taxpayer, subject to various limitations.[8]

Generally, taxpayers itemize deductions only when their total allowable itemized deductions are higher than the standard deduction. As a result, many taxpayers with home mortgage interest will not benefit from the deduction. In 2018, 18% of U.S. homeowners claimed the home mortgage interest deduction,[9] which is slightly less than half of the 37% of U.S. homeowners who had a mortgage.[10]

Example: Drugstores & Health FSA Funds

Another example of businesses potentially providing misleading information is in the context of drugstores providing information to customers

about health FSA funds. If an individual's employer provides the option to participate in a health FSA, the individual can elect to participate and can specify a dollar amount of their compensation (up to an annual cap) that will be contributed to the FSA for the upcoming year.[11] Amounts contributed to a health FSA are not subject to income taxation but can only be used for certain medical expenses of the employee, the employee's spouse, the employee's dependents, and certain other persons.

Health FSAs are subject to a "use-it-or-lose-it" rule, meaning the employee forfeits any amounts not spent on eligible expenses that remain in the account at the end of the year.[12] However, each employer's plan can either 1) provide a grace period of up to 2½ months[13] or 2) allow up to a certain amount of unused funds at the end of any year to be carried forward to the following year.[14] For 2026, the cap on the amount that can be carried forward is $680.[15] A plan can include either (or neither) of these two features but not both.[16] If the employer makes the first option available to the fullest extent allowed, for instance, an employee is given 2½ months in 2027 to spend on eligible expenses any amount remaining in the account at the end of 2026. If the employer makes the second option available to the fullest extent allowed and there is some amount remaining in an employee's account at the end of 2026, the employee can use up to $680 of that amount on eligible expenses anytime in 2027.

A drugstore's website might warn customers about the use-it-or-lose-it feature and encourage them to spend their FSA funds "now" before they expire without mentioning the possibility of grace periods or the potential ability to carry some funds forward to the following year.[17] Moreover, grace periods and the ability to carry over funds to the subsequent year were not always permitted — the former has been authorized since 2005 and the latter since 2013.[18] The fact that these features were not always allowed and the fact that different plans adopt different features might compound the extent to which such a website statement could cause customers to think the funds will expire sooner than they do.

Consequently, such a statement might encourage customers to go on a medical shopping spree, even if the FSA funds remain available longer. This potential effect runs counter to one of the IRS's articulated rationales for allowing carryover of some unused funds to the subsequent year, namely, "the desirability of minimizing incentives for unnecessary spending at the end of a year or grace period."[19]

Similarly, another drugstore might inform customers that "in most cases" FSA funds will not roll over but "in some cases" their employers may allow an extra 2.5 months or allow rollover of a specified amount to the following year.[20] At least according to one source of data, in fact, 42% of plans allow for a rollover, 26% of plans allow for a grace period, and only 33% provide for neither.[21] Thus, in fact, rollovers or grace periods are allowed in most cases.

Example: Debt Collectors & Treatment of Discharged Debt as Income

As one final example, consider how debt collectors provide information to debtors about the tax consequences of paying less than the amount owed. Generally, when a taxpayer borrows money, they do not include the borrowed proceeds in their income for tax purposes. Tax law does not treat the borrowed proceeds as income because the taxpayer has not, by borrowing, benefited from an increase in wealth given that the taxpayer takes on an offsetting obligation to repay the amount borrowed. If, however, the taxpayer's obligation to repay the borrowed proceeds is later forgiven, the taxpayer generally must include, in income, the amount that is forgiven, which constitutes discharge-of-indebtedness income.[22]

For example, if a taxpayer borrows $1,000 in year 1, and, in year 2, $200 of that amount is forgiven so that the taxpayer is required to repay only $800, the taxpayer realizes $200 of discharge-of-indebtedness income in year 2. The taxpayer did not include $1,000 in income in year 1 because the tax system assumed the taxpayer would repay the $1,000 so that they were not made $1,000 better off by borrowing. When it turns out that the taxpayer does not, in fact, have to repay $200 of that $1,000 amount, the taxpayer must include $200 in income.

The requirement to include in income discharge-of-indebtedness income is subject to numerous exceptions.[23] To name just two, a borrower can exclude from income discharge-of-indebtedness income that occurs in bankruptcy or when the taxpayer is insolvent (at least to the extent they are insolvent in the latter case).[24]

To backstop the debtor's obligation to include in income discharge-of-indebtedness income, creditors who forgive debts have information-reporting obligations in some cases.[25] In particular, certain creditors must file a Form 1099-C with the IRS if they cancel debt of any person unless the amount of any cancellation is less than $600.[26] By filing this form, the creditor provides information to the IRS about the transaction, which makes it easier for the IRS to discover any debtor's failure to pay tax on discharge-of-indebtedness income.

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However, the creditor's obligation to file a Form 1099-C does not align precisely with the debtor's obligation to include the discharged debt in income for two reasons. First, even if the debtor can exclude the discharged debt from income (because the debtor is insolvent for instance) generally the creditor must report information about the transaction to the IRS on Form 1099-C as long as the amount cancelled is at least $600.[27] Second, even if the creditor is not required to file a Form 1099-C (because, for instance, the amount of debt discharged is less than $600), the debtor must still include in income discharge of debt, assuming no exception applies (such as the debtor being insolvent).[28]

In various cases, plaintiffs have brought claims against debt collectors under the Fair Debt Collection Practices Act (FDCPA) based on tax law information included in debt-collection letters. In *Dunbar v. Kohn Law Firm S.C.*, the plaintiffs received debt-collection letters that offered to settle debt for less than the amount owed and stated, "This settlement may have tax consequences."[29] The plaintiffs alleged that the statements were misleading because the plaintiffs were insolvent so they could exclude debt cancellation from income.[30]

The U.S. Court of Appeals for the Seventh Circuit affirmed the lower court's decision to dismiss for failure to state a claim.[31] As the Seventh Circuit explained, "The challenged statement is not false or misleading because 'may' does not mean 'will' and insolvent debtors might become solvent before settling their debt, triggering the possibility of tax consequences."[32] The court was not persuaded by the plaintiffs' argument that "most recipients of debt-collection letters are insolvent and therefore would incur no tax liability from a discharged debt."[33]

By contrast, plaintiffs have been more successful when they allege violations of the FDCPA based upon statements that indicate that a creditor may report the cancelled debt to the IRS when, in fact, reporting is unlikely given that the amount of debt forgiven does not exceed $600.[34] For example, in *Heredia v. Capital Management Services L.P.*, the plaintiff received a debt-collection letter that included a variety of settlement offers, none of which resulted in forgiving more than $600 of debt.[35] The letter stated, "Settling a debt for less than the balance owed may have tax consequences and [the creditor] may file a 1099C form."[36]

The court noted that, just as in *Dunbar*, stating that the settlement "may have tax consequences" is not misleading.[37] However, declaring that the creditor "may file a 1099C form" is misleading because, given the amount of debt forgiveness, filing the form was not required and the creditor did not contradict the plaintiff's assertion that the creditor would never file the form unless required.[38] The court elaborated on one further distinction between these two statements, writing, "Only the debtor knows whether, given her financial situation as a whole, she will

have to pay taxes on the forgiven debt. The creditor, however, knows whether it will have to file a 1099C form or not."[39]

It is worth reiterating that the creditor's obligation to file a Form 1099-C does not align precisely with the debtor's obligation to include the discharged debt in income. Existing case law elevates the importance of the creditor providing correct information about whether they will issue a Form 1099-C over providing complete information about the debtor's tax treatment.[40] While there is a practical rationale for drawing this distinction (namely, the court's observation about information that the creditor possesses), it is worth noting that what ultimately matters to the taxpayer is whether they must include the discharged debt in income.

Conclusion

As the above examples demonstrate, taxpayers receive information about tax law from a variety of sources – not just from their tax advisors or the IRS. In addition, some of the information is dispensed when a taxpayer is deciding not how to file a tax return but whether to engage in a transaction. For instance, the taxpayer receives information when they are deciding how much mortgage debt to incur, whether to use health FSA funds before year end, or how much debt to repay. In the midst of tax season, many think about taxes more than might otherwise be the case, and, when it comes to filing, approximately 90% of taxpayers seek assistance from paid preparers or make use of tax return filing software.[41] By contrast, seeking professional tax guidance before making decisions during the year is surely much less common. As a result, the role that other parties play in providing tax law information should not be overlooked. **WL**

ENDNOTES

[1]See Emily Cauble, *Channels of Tax Law (Mis)Information*, 26 U. Ill. L. Rev. 543 (2026).

[2]Howard Gleckman, *How Doctors Are Expanding Access to the Earned Income Tax Credit*, Tax Pol'y Ctr. (Aug. 17, 2018), https://www.taxpolicycenter.org/taxvox/how-doctors-are-expanding-access-earned-income-tax-credit.

[3]Lucy E. Marcil, et al., *Free Tax Services in Pediatric Clinics*, 141 Pediatrics 1 (2018). *See also*, Michael K. Hole, Lucy E. Marcil & Robert J. Vinci, *Improving Access to Evidence-Based Antipoverty Government Programs in the United States*, 171 JAMA Pediatrics 211, (2017).

[4]For further discussion, see Cauble, *supra* note 1.

[5]For further discussion, see Cauble, *supra* note 1.

[6]*See* I.R.C. § 62(a) (omitting the deduction for home mortgage interest from the list of deductions used to compute adjusted gross income that are allowed if an individual does not elect to itemize); I.R.C. § 63(d) (defining *itemized deductions* as deductions other than those allowed in arriving at adjusted gross income and other than those listed in I.R.C. § 63(b)).

[7]I.R.C. § 63(c).

[8]I.R.C. § 63(b), (d), (e).

[9]Mark P. Keightley, Cong. Rsch. Serv., R46685, *An Analysis of the Geographic Distribution of the Mortgage Interest Deduction: Before and After the 2017 Tax Revision (P.L. 115-97)* 5 (2021), https://crsreports.congress.gov/product/pdf/R/R46685 [https://perma.cc/E67U-JVRX].

[10]U.S. Bureau of Lab. Stats., *Consumer Unit Characteristics: Percent Homeowner with Mortgage: All Consumer Units* (2024), https://fred.stlouisfed.org/series/CXU980230LB0101M [https://perma.cc/62N5-SST3].

[11]*See* I.R.C. § 125(i)

[12]*See* Notice 2005-42, 2005-23 I.R.B. 1204.

[13]*Id.* at 1205 (allowing employers to provide a grace period that extends beyond the end of the year to use amounts for eligible expenses rather than forfeit the contributions, but specifying that the grace period cannot extend beyond the 15th day of the third calendar month after the end of the preceding year).

[14]Notice 2013-71, 2013-47 I.R.B. 532. The amount that can be carried over was later inflation adjusted by making it equal to 20% of the maximum amount that can be contributed to an FSA (which is an inflation-adjusted figure). Notice 2020-33, 2020-22 I.R.B. 870.

[15]Rev. Proc. 2025-32 (Oct. 17, 2025), § 4.15.

[16]Notice 2013-71, 2013-47 I.R.B. 532 ("This modification permits [I.R.C.] § 125 cafeteria plans to be amended to allow up to $500 [this dollar amount was later adjusted] of unused amounts remaining at the end of a plan year in a health FSA to be paid or reimbursed to plan participants for qualified medical expenses incurred during the following plan year, *provided that the plan does not also incorporate the grace period rule.*") (emphasis added).

[17]For further discussion, see Cauble, *supra* note 1.

[18]Notice 2013-71, 2013-47 I.R.B. 533; Notice 2005-42, 2005-23 I.R.B. 1204.

[19]Notice 2013-71, 2013-47 I.R.B. 533.

[20]For further discussion, see Cauble, *supra* note 1.

[21]*FSA Database*, Emp. Benefit Rsch. Inst., https://www.ebri.org/health/fsa-database [https://perma.cc/WEC9-8DBH].

[22]I.R.C. § 61(a)(11).

[23]I.R.C. § 108.

[24]I.R.C. § 108(a)(1)(A)-(B). In such a case, however, the taxpayer may have to adjust various tax attributes that could cause the taxpayer to recognize more income later. *Id.*; I.R.C. § 108(b).

[25]I.R.C. § 6050P(a), (b).

[26]*Id.*; Treas. Reg. § 1.6050P-1(a).

[27]Treas. Reg. § 1.6050P-1(a)(3) ("Except as otherwise provided in this section, discharged indebtedness must be reported regardless of whether the debtor is subject to tax on the discharged debt under sections 61 and 108 or otherwise by applicable law."). In some instances, reporting is not required when debt is discharged in bankruptcy. Treas. Reg. §1.6050P-1(d).

[28]I.R.C. § 61(a)(11); I.R.C. § 108.

[29]896 F.3d 762, 764 (7th Cir. 2018)

[30]*Id.* Even if the taxpayer excludes the discharged debt from income, the taxpayer might have to reduce tax attributes as noted above. *See* I.R.C. § 108. In that sense, the settlement has potential tax consequences even if excluded from income, although this was not an issue the court discussed.

[31]*Dunbar*, 896 F.3d at 764.

[32]*Id.*

[33]*Id.* at 765. The court also called into question a Northern District of Illinois decision that had found similar reasoning persuasive. *Id.* at 767.

[34]*See, e.g.*, *Heredia v. Capital Mgmt. Servs.*, 942 F.3d 811, 814 (7th Cir. 2019).

[35]*Id.* at 814.

[36]*Id.*

[37]*Id.* at 815.

[38]*Id.* at 815.

[39]*Id.* at 815-16.

[40]*See id. at* 811.

[41]*See, e.g.*, Jay A. Soled & Kathleen DeLaney Thomas, *Regulating Tax Return Preparation*, 58 B.C. L. Rev.152, 156 n.29 (2017) (quoting an IRS commissioner's testimony that "'[e]ach year, paid preparers are called upon by taxpayers to complete about 80 million returns, or about 56 percent of the total individual income tax returns filed, while another 34 percent of taxpayers use tax preparation software, for a total of 90 percent who seek some form of assistance.'") **WL**