

John Balian

*Professor John Balian is a faculty member of the Bookstein Tax Clinic. The Bookstein Tax Clinic is part of the Bookstein Institute for Higher Education in Taxation at California State University, Northridge. Professor Balian obtained his B.S. in Accounting and M.S. in Taxation from California State University, Northridge and his J.D. from Southwestern University School of Law.*



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## **You may owe taxes on debts forgiven**

An unknown fact to most taxpayers is that the IRS taxes you on debt that is forgiven by your lender. This forgiven liability is called income from cancellation of debt. Income from the cancellation of debt occurs when one borrows money from a lender and the lender later cancels or forgives the debt. Typically, loan proceeds received are not taxable as income by the IRS because there is an obligation for you to repay the lender. However, once the obligation is removed, the proceeds become income.

While circumstances vary, you may be required to include the amount of debt that was cancelled as income for tax purposes and as a result have the income taxed. For example, if you were to borrow \$10,000 from the bank and you are able to renegotiate with your lender to reduce the loan to \$7,000 and thus forgive \$3,000 then you would be responsible for including the \$3,000 as income on your tax return.

If you have forgiven/cancelled debt, then your lender should send you a Form 1099-C, Cancellation of Debt, by January 31 of the following year.

There are standard exceptions and exclusions in which debt income may not be taxed which are bankruptcy, insolvency, student work loans, non-recourse loans and certain farm debts. To fall under the bankruptcy exception the taxpayer must file for bankruptcy prior to foreclosure. Insolvency, which is often difficult for taxpayers to meet due to owning property or having a pension, is an exception that requires the taxpayer's total debts to be more than the taxpayer's total assets. Student loans may be forgiven tax free if the taxpayer works for certain employers. By their inherent nature, non-recourse loans do not result in forgiveness of debt income if they are forgiven because the lender cannot pursue you personally for default. For farm debts, the debt must be directly related to the operation of a farm.

Recent legislation has allowed taxpayers to avoid taxes on forgiven mortgage debt. An act which was passed in December 2007, appropriately titled The Mortgage Forgiveness Debt Relief Act, permits debt forgiveness tax free on loans for principle residences and refinanced debt on a principal residence for the tax years 2007-2009. The limit of the act is that the principal loan balance can not exceed \$1 million (\$2 million jointly). Unfortunately, the act does not apply to mortgage debts on second homes, credit card loans, or car loans.