DO YOU HAVE CANCELLED DEBT?

Lost your home to foreclosure? Had your car repossessed? Did a credit card company cancel your loans and forgive some or all of your debt? Did you know that debt forgiveness may result in taxable income?

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What is Cancellation of Debt income?

Generally, if you are personally liable for a debt, and it is forgiven or satisfied for a lesser amount, you have **cancellation of debt income**. Cancellation of debt income is *taxable*. However, there are some ways in which a cancelled debt can be *excluded* from income.

I received a Form 1099-C. What does this mean?

Lenders are required to send to you (and the IRS) a Form 1099-C, Cancellation of Debt, if the amount forgiven or canceled is $600 or more. The amount of the debt forgiven or cancelled will be shown in box 2. Notify your lender immediately if any of the information shown on Form 1099-C is incorrect.

I received a Form 1099-A. What does this mean?

Lenders are required to send you a Form 1099-A, Acquisition or Abandonment of Secured Property, in cases where there has been an **abandonment** or **foreclosure** of property that is security for a debt for which you are the borrower.

What's the difference between a "recourse" and "non-recourse" loan?

"Recourse" means you're personally liable for the debt. All other debt is "non-recourse". Generally, there is no cancellation of debt for non-recourse loans. You will receive a 1099-A if there was a foreclosure or property abandonment; you will receive a 1099-S if there was a short sale. There may be cancellation of debt income for recourse loans. You will receive a 1099-C (and sometimes also a 1099-A) if there has been a foreclosure or property abandonment; you will receive a 1099-C and 1099-S if there was a short sale.

When may a cancelled debt be excluded from income?

There are three common situations where you may not have to report cancelled debt as income:

1. Loan modification or foreclosure of your **principal residence** during or after 2007.
   a. This includes debt used to buy, build, or substantially improve your principal residence. The debt must be secured by the home.
2. Debts discharged through a **bankruptcy**.
3. **Insolvency** if your total debts exceeded the total value of your assets at the time your debt was cancelled, settled, or deemed non-collectible.

You can use the Interactive Tax Assistant available on the IRS website to determine if the cancellation of debt is taxable (http://www.irs.gov/uac/Do-I-Have-Cancellation-of-Debt-Income-on-My-Personal-Residence%3F).

Do I qualify for the insolvency exception?

You are insolvent if your total liabilities or debts, including the cancelled debt, was greater than your total assets at the time your debt was cancelled. Or, put more simply – you owe more than you have.

For example, if your total debts were $8,000 and the value of your total assets at the time was $6,000, you subtract your assets from your debt and you are insolvent in the amount of $2,000.
Then:

1. If you received a 1099-C for $1,000, you may exclude the entire $1,000 from income.
2. If you received a 1099-C for $2,000, you may exclude the entire $2,000 from income.
3. If you received a 1099-C for $3,000, you may only exclude $2,000, the extent to which you are insolvent. You would have $1,000 of cancelled debt income.

Confused? Contact our Tax Clinic Hotline below.

How much are my assets worth?

Assets include the value of everything you own (including assets that are mortgaged, any pension plans and retirement accounts). Use the fair market value or what you would get if you sold them, rather than what you paid for them or what you think they are worth.

How do I exclude a forgiven debt on my tax return?

The amount of debt forgiven is not reported on your Form 1040. But it must be reported on Form 982 and this form must be attached to your tax return.

Our Tax Clinic may be able to assist you in determining whether or not you may exclude your forgiven debt from income, as well as completing Form 982. Do not ignore notices from the IRS!

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The Center for Economic Progress (CEP) helps low-income individuals and families move from financial uncertainty to financial security.
www.economicprogress.org

Tax Clinic Help Line:
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