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## **IRS Form 1099-C: Cancellation of Debt**

### **Overview**

This document is designed to provide information and instruction for individuals who have received a [Cancellation of Debt \(COD\)](#) IRS Form 1099-C.

If you have reached a compromise or settlement with a creditor agreeing to release you from any further obligations regarding the repayment of a debt, a credit card debt for example, your responsibilities may not end at this point. Your creditor may "write off" all or part of the debt it claims that you owe, and report it as a tax loss to the IRS using a Form 1099-C.

Because you never paid the debt-claim in full, the IRS can treat a cancellation of a debt-claim as income you have received. For example, \$4,500 credit card bill in which a compromise has been reached to settle the debt for \$2,500 is in theory a \$2,000 personal net gain. The IRS may require you to report this as income you have received for the tax year even though you have not actually received the money.

### **Why did I receive a 1099-C: Cancellation of Debt form?**

If you have defaulted (failed to make payments as agreed) on a debt in the past and you have either reached a compromise with a creditor to settle your debt, or the creditor has deemed the debt to be non-collectable and has stopped attempts to recover, you may receive a 1099-C form. The IRS definition of a compromise in a collection case is the discharge of indebtedness under an agreement between the creditor and the debtor to cancel the debt at less than full consideration.

### **What is a 1099-C: Cancellation of Debt form?**

A 1099-C form lets you know that a creditor is going to “write off” the remaining unpaid portion of your debt. An IRS 1099-C: Cancellation of Debt form is filed by a creditor to the IRS when a settlement agreement between a debtor and a creditor has been reached or when a creditor has determined that a debt will never be paid. If the debt is for \$600 or more the creditor must send you, the debtor, a 1099-C in the mail by January 31<sup>st</sup> and to the IRS by February 28<sup>th</sup> of the tax year in which the debt was discharged.

### **What should I do after I receive a 1099-C: Cancellation of Debt form?**

If you receive a 1099-C form from a creditor, you must report the amount of the canceled debt as income to the IRS even though you have not actually received the money. (The amount shown in Box 2 of the 1099-C form is the amount that must be reported as income.)

### **What debts are forgiven under a 1099-C: Cancellation of Debt form?**

The IRS recognizes five situations where a cancelled debt does not have to be reported as income.

1. Bankruptcy – the debt was already discharged through a bankruptcy proceeding.
2. Insolvency – your total debts exceed your total assets at the time your debt was settled or deemed non-collectable.
3. Indebtedness is due to a qualified farm expense.
4. Indebtedness is due to certain real property business losses.
5. Discharge of your debt was treated as a gift. (Extremely rare)

If you are insolvent you need to explain this to the IRS in one of two ways. 1) By filling out IRS Form 982 (Can be difficult to understand): Reduction of Tax Attributes Due to Discharge of Indebtedness or 2) Attaching a detailed letter to your tax return explaining the calculation of your total debts and assets.

### **How do I know if I am insolvent?**

You are deemed to be insolvent if your total liabilities (debts) are greater than your total assets. Completing the insolvency worksheet at the bottom of this document will help you determine if you were insolvent at the time your debt was discharged. For example, if your total liabilities are \$8,000 and your total assets at the time are \$6,000 you are insolvent in the amount of \$2,000. To determine the value of your assets use the fair market value rather than what you paid for them or what you think they are worth.

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**Helpful tips to avoid problems if you have received a 1099-C.**

- If you settle your debt for less than full consideration (paid in full) be sure to ask the creditor if they intend to submit a 1099-C form to the IRS.
- The name of the creditor may not be readily recognizable on the 1099-C form. The creditor may have sold the debt to a third party collection agency or the name of the parent company could be listed as the creditor.
- Look to see if the added income received from a debt cancellation will move you into a higher tax bracket. For a taxpayer in the 35% tax bracket in 2005, a \$5,000 canceled debt could cost up to \$1,750 in additional income taxes.
- You cannot claim that you never received a 1099-C form in the mail. Even if you do not receive a 1099-C form you are expected to recognize ordinary income.

**[Insolvency Worksheet Below]**

# Statement of Total Assets and Liabilities To Determine Insolvency

Name: \_\_\_\_\_  
 SS #: \_\_\_\_\_  
 Tax Year: \_\_\_\_\_

Assets as of (Date) \_\_\_\_\_:                      Liabilities as of (Date) \_\_\_\_\_:

Home(s):	\$		Credit Card Debt:	\$	
Auto(s):	\$		Mortgage(s):	\$	
Bank Accounts:	\$		Auto Loan(s):	\$	
Personal Property:	\$		Consumer Loan(s):	\$	
Stocks & Investments:	\$		Other Liabilities:	\$	
Business Interest:	\$		Other:	\$	
Other:	\$		Other:	\$	

**TOTAL ASSETS**    \$ \_\_\_\_\_                      **TOTAL LIABILITIES**    \$ \_\_\_\_\_

TOTAL LIABILITIES – TOTAL ASSETS = \$ \_\_\_\_\_  
**Amount of Insolvency**

(Note: In order to be insolvent total liabilities must be greater than total assets.)

**Legal Terms:**

**Creditor** – A person or business to whom another person who is the “debtor” owes a debt.

**Debtor** – One who owes a debt to a creditor.

**Write off** – To cancel from accounts as a loss.

**Default** – To fail to pay money when it is due.

**Fair Market Value (FMV)** – Price at which a willing seller and a willing buyer will trade.

**Net Gain** - An increase in the value of a capital asset.