

How to claim insolvency

- If you have debt cancellation, you can claim to be insolvent. If you are found to be insolvent, you only owe tax on the portion you are not considered insolvent for.
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- Example: Person A only has credit card debt totaling \$15,000, and a car with a Fair Market Value of \$10,000. Person A does not have any other assets or liabilities. Because the car is only worth \$10,000. Person A is considered insolvent for a total of \$5,000 ($\$15,000 - \$10,000 = \$5,000$) Then, if a portion of Person A's credit cards are forgiven, lets say for a total of \$7,000, Person A can exclude \$5,000 of the \$7,000, leaving them a taxable amount of only \$2,000!
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- The excluded income must be reported on **Form 982**. In the example above, **Form 982** would list the amount of \$5,000 as excluded.

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Cancellation of Debt



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Facts about Cancellation of Debt

- Cancellation of debt occurs when a loan is forgiven by a lender.
- According to the IRS, when debt is cancelled, the borrower is then put in a better position than if the loan was fully repaid.
- The IRS requires the taxpayer to include the amount of the discharge in his gross income.
- Cancelled debt is reported to the IRS on **Form 1099-C**, generally filed by the lender or creditor, and then sent to the borrower.

OMB No. 1545-1424
Form 1099-C
2 Amount of debt canceled
\$
4
Cancellation of Debt
Copy B For Debtor
This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you.



A 1099-C is Required for the following:

- A discharge in bankruptcy under **Title 11** of the U.S. Code for business or investment debt.
- A cancellation or extinguishment making the debt unenforceable in receivership, foreclosure, or similar federal or state court proceeding.
- A cancellation or extinguishment when the statute of limitations for collecting the debt expires, or when the statutory period for filing a claim or beginning a deficiency judgment proceed expires.
- A cancellation or extinguishment when the creditor elects foreclosure remedies that by law end or bar the creditors right to collect the debt.
- A cancellation or extinguishment due to probate or similar proceeding.
- A discharge of indebtedness under an agreement between the creditor and the debtor to cancel the debt at less than full consideration.
- A discharge of indebtedness because of a decision or a defined policy of the creditor to discontinue collection activity and cancel the debt.
- The expiration of nonpayment testing period.

Exceptions to paying tax on canceled debt

- Cancelled debt is **not** always taxable however, the most common situations when cancellation of debt is not taxable involve:
 - A. **Qualified principal residence indebtedness**: this was created by the Mortgage Debt Relief Act of 2007, and applies to most homeowners.
 - B. **Bankruptcy**: debts discharged through bankruptcy are not considered taxable income.
 - C. **Insolvency**: if you are insolvent (meaning your total debts exceed the fair market value of your assets) when the debt is cancelled, some or all of the canceled debt may not be taxable to you.

