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Taxation of Forgiven Debt: The 1099C & You

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Often people fall on hard times and stop paying on credit cards. After a while the account may go to an outside debt collector who might offer a settlement of the debt for 30-40% of the original sum. Once this is paid, the debtor often thinks the matter is closed, but it is not! It is very likely that the creditor will issue a 1099-C. This is a notice to IRS of the forgiven debt. If the debtor does not address this on his return he may get an IRS bill a year or two later with penalties and interest.

A foreclosure on a home may also result in a 1099-C from the mortgage lender if the property is sold for less than the amount of the loan. In this instance, a person loses their home and may also face a tax bill. Usually, the bill comes many months after the tax return was filed as a result of an IRS document matching program. This "under-reporter" notice brings grief to the taxpayer.

The key issue is whether or not the debtor was insolvent. If they were insolvent, it may not be taxable depending on the circumstances. There is an "Insolvency exclusion." You are insolvent when, and to the extent, your liabilities exceed the fair market value of your assets. So it is possible none of your forgiven debt is taxable or it is possible that all or only a portion of it is includable in income.

If you get a 1099-C, don't ignore it. Have a tax professional do your return and they can help you determine how much of the 1099-C is taxable. If you get a letter from IRS on a 1099-C you left off your return, get help ASAP. Otherwise, IRS might file a Federal Tax Lien and take action.

Look for a CPA, Enrolled Agent, Accredited Tax Advisor, Accredited Tax Preparer, or Tax Attorney to help you with serious tax issue. You may call the IRS at 1-800-829-1040 for help as well. Websites you can check out include: www.irs.gov; www.naea.org; www.nsacct.org; and www.exirsman.com.

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