



March 28, 2011

## Pay Taxes on Canceled Debt

If you have been forgiven a credit card debt, don't be too quick to celebrate. Did you know you have to pay taxes on your canceled debts? Any canceled or forgiven debt is deemed as income by the IRS, so you have to declare it as such. If you don't, you can expect the IRS to come after you.

The way it works is like this – when you are forgiven of a debt amounting to \$600 or more, the creditor issues a form called Form 1099-C, a copy of which is sent to the IRS. Using this Form 1099-C, the IRS keeps track of those whose debts have been canceled and will expect you to declare it as income.

According to the IRS, the number of 1099-C forms filed with the federal government by creditors and debt collectors grew from fewer than 1 million in 2003 to more than 1.987 million in 2008. It is estimated that the number will grow to 2.8 million filed in 2011 for the tax year of 2010. It's ironic that you get your debts cancelled because you can't afford to pay them only to owe thousands in taxes instead. Most debtors are not likely to have thousands of dollars in the bank to pay off this unexpected extra tax. If they did, they would have used the money to settle their original debt in the first place. What likely happens is the taxpayer has to borrow funds or

make installment payment plans with the IRS.

However, there are some cancelled debts that are tax-free. If student-loan debt is canceled as part of a forgiveness program for working in a particular field, such as health care in an underserved community, the debt that is forgiven is tax-free. The same is true for public-service loan-forgiveness programs.

But all other cancelled debts will be counted as income. For example, if you invested in a sure bet that turned sour or if your foreclosure debt has been forgiven, it constitutes as income.

So you need to look at look at Box 2 of Form 1099-C for the amount to be reported as “other income” on Form 1040. And make sure you find all Form 1099-Cs that you would receive from a federal government agency, credit union or bank.