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## Discharge of Debt Income Lawyers

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#### What is Discharge of Debt Income?

When you borrow money from someone and you are unable to pay that person back, you typically will have to recognize income for tax purposes if that person decides to forgive your debt. However, there are exceptions to this general rule.

#### When Will Discharge of Debt Not Be Considered Income?

There are four situations where discharge of debt is not income to the taxpayer:

1. A debt discharged under the [bankruptcy](#) code by the court;
2. The taxpayer is insolvent;
3. Debt discharged is qualified farm indebtedness; or
4. Debt discharged is qualified real property business indebtedness.

#### What Does It Mean To Be Insolvent?

For the purposes of this rule, a taxpayer is insolvent if his/her liabilities (i.e. debts) exceed the fair market value of his/her assets immediately prior to the debt discharge.

#### What Happens If The Debt Discharged Is More Than The Amount By Which The Taxpayer Is Insolvent?

In this case, the taxpayer will have to recognize income by the amount of debt discharged that exceeds the amount by which the taxpayer is insolvent.

For example: G has a debt of \$100,000 and cash of \$50,000. Before the debt discharge, G is insolvent for \$50,000. G makes a deal to settle \$80,000 of the debt for \$20,000. G will recognize

\$10,000 in discharge of debt income because the \$60,000 debt discharged (\$80,000 - \$20,000) exceeds the amount by which G is insolvent (\$50,000) by \$10,000.

### **What Is Qualified Real Property Business Indebtedness?**

Qualified real property business indebtedness is a debt incurred or assumed in connected with a piece of real property used in a trade or business and that is secured by that piece of real property.

For debts incurred or assumed after 1992, the debt proceeds must be used to acquire, construct, reconstruct, or substantially improve the real property.

Similar to debt discharge for insolvent taxpayers, the amount that the taxpayer may exclude from income for discharge of qualified real property business indebtedness is limited to the amount of the outstanding principle of the debt that exceeds the fair market value of that real property.

### **Can Discharge of Student Loans Be Excluded From Income?**

Yes, but only to a limited group of student loans. There is a special rule that applies to the discharge of student loans. A taxpayer may be able to exclude part or all of his/her discharged student loans if pursuant to the loan agreement, he/she works for a specific period of time in certain profession for any of a broad class of employers in exchange for the discharge.

For the purposes of this rule, only the following student loans qualify for this exclusion:

1. Loans from federal, state, or local government;
2. Loans from certain tax-exempt public benefit corporation; and
3. Loans from certain educational institutions.

### **Are There Exceptions To The Discharge of Debt Income Exclusion Rules?**

There are several exceptions to the general rule; two notable exceptions are as follows:

1. There is no income if the debt that was discharged would have been [deductible](#) had it been paid.
2. When a seller sells property to a buyer on credit, the buyer can treat the debt discharged by the seller as a purchase price adjustment to the property bought.

### **Do I Need an Attorney to Help Me with My Tax Problems?**

Tax laws are complex and ever-changing. Although there are various tax preparation softwares on the market that may help you with your tax problems, they cannot provide the same level of service that an experienced and knowledgeable tax attorney can. If you are unsure about the characterization of your losses or you need someone to represent you before the IRS, a tax attorney can help you.

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