Top 10 Tax Tips about Debt Cancellation

If your lender cancels part or all of your debt, it is usually considered income and you normally must pay tax on that amount. However, the law allows an exclusion that may apply to homeowners who had their mortgage debt cancelled in 2015. Here are 10 tips about debt cancellation:

1. **Main Home.** If the cancelled debt was a loan on your main home, you may be able to exclude the cancelled amount from your income. You must have used the loan to buy, build or substantially improve your main home to qualify. Your main home must also secure the mortgage.

2. **Loan Modification.** If your lender cancelled part of your mortgage through a loan modification or 'workout,' you may be able to exclude that amount from your income. You may also be able to exclude debt discharged as part of the Home Affordable Modification Program, or HAMP. The exclusion may also apply to the amount of debt cancelled in a foreclosure.

3. **Refinanced Mortgage.** The exclusion may apply to amounts cancelled on a refinanced mortgage. This applies only if you used proceeds from the refinancing to buy, build or substantially improve your main home and only up to the amount of the old mortgage principal just before refinancing. Amounts used for other purposes do not qualify.

4. **Other Cancelled Debt.** Other types of cancelled debt such as second homes, rental and business property, credit card debt or car loans do not qualify for this special exclusion. On the other hand, there are other rules that may allow those types of cancelled debts to be nontaxable.

5. **Form 1099-C.** If your lender reduced or cancelled at least $600 of your debt, you should receive Form 1099-C, Cancellation of Debt, by Feb. 1. This form shows the amount of cancelled debt and other information.

6. **Form 982.** If you qualify, report the excluded debt on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness. File the form with your federal income tax return.

7. **IRS.gov Tool.** Use the Interactive Tax Assistant tool on IRS.gov to find out if your cancelled mortgage debt is taxable.

8. Exclusion Extended. The law that authorized the exclusion of cancelled debt from income was extended through Dec. 31, 2016.

9. **IRS Free File.** IRS e-file is fastest, safest and easiest way to file. You can use IRS Free File to e-file your tax return for free. If you earned $62,000 or less, you can use brand name tax software. The software does the math and completes the right forms for you. If you earned more than $62,000, use Free File Fillable Forms. This option uses electronic versions of IRS paper forms. It is best for people who are used to doing their own taxes. Free File is available only on IRS.gov/freefile.

10. **More Information.** For more on this topic see Publication 4681, Canceled Debts, Foreclosures, Repossessions and Abandonments.

Each and every taxpayer has a set of fundamental rights they should be aware of when dealing with the IRS. These are your Taxpayer Bill of Rights. Explore your rights and our obligations to protect them on IRS.gov.

Additional IRS Resources:

- Tax Topic 431 - Canceled Debt – Is It Taxable or Not?
- Home Foreclosure and Debt Cancellation