DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF CHIEF COUNSEL

April 14, 2009

Number: **INFO 2009-0085**
Release Date: 6/26/2009

CC:ITA:B04
CONEX-115362-09

UIL: 61.00-00, 108.00-00, 108.01-02, 108.01-03, 6050P.00-00

The Honorable Phil Hare
Member, U.S. House of Representatives
261 North Broad #5
Galesburg, IL 61401

Dear Congressman Hare:

I am responding to your inquiry, dated March 4, 2009, on behalf of your constituent, . She asks why she owes taxes on a cancelled debt of $ after losing her home. Apparently, her lender furnished her with a Form 1099-C, Cancellation of Debt, showing a cancelled debt of $.

I hope that the following information is helpful in responding to .

Gross income includes all income from whatever source derived, including income from discharge of indebtedness (section 61(a)(12) of the Internal Revenue Code (Code)). Generally, discharge of indebtedness income arises because a taxpayer who receives cash through a loan does not recognize the receipt of the cash as income because there is an offsetting obligation to repay the cash. If the offsetting obligation is later discharged, that discharge triggers income realization. *See Commissioner v. Tufts*, 461 U.S. 300 (1983). Thus, would generally realize income when her lender discharged her obligation to repay the unpaid $ on her mortgage loan.

In certain situations, however, taxpayers may exclude discharge of indebtedness income from gross income. For example, if qualified principal residence indebtedness ("qualified debt") is discharged on or after January 1, 2007, and before January 1, 2013, the amount discharged generally is excluded from gross income (section 108(a)(1)(E) of the Code). In addition, if a discharge of indebtedness occurs when a taxpayer is insolvent, the amount of debt discharged is excluded from gross income up to the amount by which the taxpayer is insolvent (sections 108(a)(1)(B) and 108(a)(3) of the Code). Insolvency is defined as the excess of liabilities over the fair market value of assets, based on the taxpayer's assets and liabilities immediately before the debt discharge (section 108(d)(3) of the Code).

Unfortunately, it appears that does not qualify for the qualified debt exclusion, because her foreclosure was in 2006, before the effective date of section 108(a)(1)(E). However, if she was insolvent immediately before her debt was discharged, she may qualify for the insolvency exclusion.

Applicable financial entities must issue a Form 1099-C for the year in which an identifiable event occurs, such as cancellation of a debt in a foreclosure making the debt unenforceable (section 1.6050P-1(b)(2) of the Income Tax Regulations (Regulations)).

If you have additional questions, please contact me or at
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Sincerely,

Michael J. Montemurro
Branch Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)