When you owed a debt, but the debt was forgiven or “cancelled,” the IRS considers the cancelled debt to be income that you generally must include on your federal tax return. However, the IRS may allow you to “exclude” the cancelled debt as income on your tax return in some situations.

Here are a few examples of times you may not have to pay income tax on cancelled debt:

1) **Foreclosure, workout, or short sale** (between 2007 and 2017).
2) **Bankruptcy**, if you discharged the debt in bankruptcy court.
3) **Student loan debt discharged due to death or permanent and total disability** (between 2018 and 2025).
4) **Insolvency**, if your total debt was higher than the total value of your assets immediately before the debt (including mortgage debt) was cancelled. IRS publication 4681 has an example of a worksheet that can help you figure out if you are insolvent.

If you receive a “Form 1099-C: Cancellation of Debt” like the one above, take it to your tax preparer. Your tax preparer can help you fill out an IRS “Form 982: Reduction of Tax Attributes Due to Discharge of Indebtedness,” which you will need to include with your federal tax return.

Call 211 and ask the First Call for Help Operator about FREE tax preparation in your area. Questions about a letter from the IRS? Call Legal Aid at 888.817.3777 for help.

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