

Duvall & Associates, Inc.

Taking Care of Business

CANCELLED DEBT - WIN THEN LOSE

"Some gotta win, some gotta lose. Good Time Charlie's got the blues."
Elvis

In these financially troubled times, taxpayers have been desperately maneuvering to preserve financial and credit lifelines. Enter the world of debt negotiation.

The IRS lives by the motto "you can't get somethin' for nothin'" and is bolstered in this endeavor by the proliferation of tax information reporting.

Let's assume you borrow \$20,000 from a bank and use the funds to party and vacation in Europe. Months later, you discover you cannot repay the loan - yet manage to successfully negotiate a debt reduction wherein you repay only \$5,000.

Winner? Yes - until the tax-man cometh. Unfortunately, in the tax world you received \$20,000 - repaid only \$5,000 - hence the \$15,000 benefit is now taxed as cancellation of debt income. And the IRS will be adequately informed of the tax event by the financial institution's filing of a Form 1099 to dutifully report the debt forgiveness.

There are exceptions to this often surprising result. If you are insolvent or you used the funds to buy an asset or you argue the unpaid monies were a gift (only from an individual lender), then you may be able to navigate free of taxes.

Example - You buy a residence for \$250,000 with a \$50,000 down-payment and a mortgage of \$200,000. A year later you sell the house for only \$150,000 and default on the balance of the mortgage. No taxable gain results on the debt forgiveness since all borrowed monies went into the home and effectively you lost your arse (at minimum your \$50,000 down-stroke) on the series of transactions.

Remember - if you get somethin' for nothin' the tax man may not be far away - so plan tax options well in advance.

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