Can the IRS Tax Forgiven Debt?

Often, yes, and this is one of the more overlooked pieces of the settlement process. The amount of debt forgiven through a settlement can be treated as taxable income.

How this actually works

When a creditor agrees to accept less than the full amount owed, the forgiven portion, the difference between the original balance and what was actually paid, can be reported to the IRS as income to you. If a single creditor forgives $600 or more, they are generally required to issue a Form 1099-C, Cancellation of Debt, which is also sent to the IRS.

What this means at tax time

- ✓ **It gets reported as income on your tax return.** The forgiven amount shown on a 1099-C generally needs to be included when you file, and it can increase what you owe in taxes for that year.
- ✓ **It arrives separately from your settlement paperwork.** A 1099-C typically comes directly from the creditor, often early in the following year, and it is worth watching for and keeping alongside your other tax documents.

A significant exception worth knowing

The IRS provides an insolvency exclusion: if your total debts exceeded your total assets immediately before the settlement, some or all of the forgiven amount may not be taxable. This determination involves real calculation and paperwork, and it is worth discussing with a tax professional rather than assuming either outcome.

The bottom line

This is a real cost to plan for, not a footnote. Setting aside the possibility of a tax liability, and speaking with a tax professional as settlements are completed, is a sensible part of managing a program from start to finish.