**Q 8040. Is discharge of debt specifically included in gross income?**

The discharge of debt is an economic benefit includible in gross income (see Q 8039). Assuming the forgiven debt is a “pure” discharge, it is deemed to be “income from discharge of indebtedness” specifically includible in gross income pursuant to IRC section 61(a)(12). For this purpose, pure discharge of debt requires an unconditional forgiveness for no consideration.[[1]](#endnote-1)

*Example*: Asher borrows $10,000 to take a 2 week European vacation. Two years later, when the loan becomes due, Asher defaults. In lieu of pursuing a legal collection action against Asher, the lender forgives the entire loan. Because the forgiveness of the loan was unconditional and Asher did not tender any consideration to the lender, the $10,000 forgiveness is considered to be “income from discharge of indebtedness” includible in gross income under IRC section 61(a)(12).

**Q 8041. Can discharge of debt that is not specifically included in gross income under IRC Section 61(a)(12) be included in gross income under any other section?**

Clearly, the discharge of the obligation to repay debt is an economic benefit received by the debtor. As discussed in Q 8040, above, the unconditional discharge of debt for no consideration is includible in gross income under IRC Section 61(a)(12). On the other hand, if the taxpayer provides consideration to the creditor, the discharged debt is treated as the receipt of money from the creditor in exchange for such consideration -- which the taxpayer in turn uses to repay the debt. Under those circumstances, the ensuing income will not be includible under IRC Section 61(a)(12).

*Example*: Asher borrows $10,000 from his employer to take a 2 week European vacation. When the loan becomes due, Asher’s employer forgives the debt. Because of their employee/employer relationship, the amount of the discharged debt is treated as compensation (not income from discharge of indebtedness). In other words, it is as if Asher’s employer paid Asher $10,000 as compensation which Asher in turn used to repay the debt. Therefore, the forgiven debt is included in gross income under IRC Section 61(a)(1) rather than IRC Section 61(a)(12).[[2]](#endnote-2)

*Example*: Asher borrows $10,000 from Ashley to take a 2 week European vacation. When the loan becomes due, Asher is unable to repay. In lieu of repayment, Ashley accepts a painting from Asher worth $10,000 he purchased 3 years ago for $2,000. In this case, the transfer of the painting to Ashley is treated as a sale for $10,000 which Asher in turn used to repay the debt. For tax purposes, Asher must include $8,000 in gross income ($10,000 minus $2,000 (basis in painting)) under IRC Section 61(a)(3).

**Q 8042. Is it possible for a portion of debt forgiveness to be treated as “income from discharge of indebtedness” includible in gross income under IRC Section 61(a)(12) and a portion includible under some other section?**

Yes. This would occur if the taxpayer provided partial consideration for the discharged debt.

*Example*: Asher borrows $10,000 from Ashley to take a 2 week European vacation. When the loan becomes due, Asher is unable to repay. In lieu of repayment, Ashley accepts a painting from Asher worth $8,000 he purchased 3 years ago for $2,000 and forgives the balance of the debt ($2,000). In this case, the transfer of the painting to Ashley is treated as a sale for $8,000 which Asher in turn uses to partially repay the debt. For tax purposes, Asher must include $6,000 in gross income ($8,000 minus $2,000 (basis in painting)) under IRC Section 61(a)(3). As to the remaining $2,000, since Ashley forgave this amount for no consideration, Asher must include it in gross income under IRC Section 61(a)(12). This result in $6,000 includible under IRC Section 61(a)(3) and $2,000 includible under IRC Section 61(a)(12).

1. Treas. Reg. § 1.61-12. [↑](#endnote-ref-1)
2. Treas. Reg. § 1.61-12. [↑](#endnote-ref-2)