**Q. 8055. Under what circumstances is discharge of debt income excluded from gross income?**

IRC Section 108 provides a number of exclusions of discharge of debt from gross income. Those exclusions include the following:

**Discharge in bankruptcy.**

If the discharge occurs in any type of bankruptcy proceeding (i.e., Chapter 7, Chapter 11, Chapter 13), none of the discharged debt is included in gross income.

**Insolvency**

If prior to the discharge, the taxpayer is insolvent, the discharged debt is excluded from gross income to the extent of the taxpayer’s insolvency. A taxpayer is insolvent to the extent his or her liabilities exceed the fair market value of assets as determined immediately prior to the discharge.

*Example*: In 2015, a lender forgives Asher’s $200,000 recourse loan for no consideration. Prior to the discharge, the fair market value of Asher’s assets was $100,000 and the aggregate amount of his liabilities (including the $200,000 recourse loan) was $400,000. Thus, prior to the discharge, Asher was insolvent to the extent of $300,000 ($400,000 minus $100,000). Immediately following the discharge of the $200,000 loan, Asher was insolvent to the extent of $100,000 ($200,000 minus $100,000). Because Asher was insolvent before and after the discharge, the entire $200,000 discharge of debt is excluded from gross income.