Consumers are often surprised to learn that forgiven debt often is taxable to them. Bankruptcy is one exception to this rule. If debt is discharged in the bankruptcy process, you do not owe taxes on the unpaid amount of the debt.

Nevertheless, you may receive an IRS Form 1099-C from one or more creditors listing the amount you discharged in bankruptcy as canceled debt income. This form also goes to the IRS, and the IRS will treat this as a report of income to you, unless you explain it away. Attach an explanation to your tax form which includes your bankruptcy case number and the date of the discharge. Since tax laws are complicated, you may want to seek the advice of a qualified tax professional.

Source: National Consumer Law Center, Surviving Debt [50th NCLC Anniversary Edition], updated at www.nclc.org/library
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