

ST14-01 Cancellation of Debt – Credit Card

See Screening Sheet on page D-32 of Pub 4012 to determine if COD is in scope.

Taxpayer receives a 1099-C from a credit card company or bank. The amount of the debt canceled is shown in Box 2 of 1099C.

- Canceled debt is generally considered income and is reported on the 1040, line 21, other income, UNLESS the taxpayer was in bankruptcy or insolvent (i.e., the taxpayer’s liabilities exceeded assets) immediately before the debt was canceled.
- If the taxpayer was in bankruptcy or insolvent immediately before the debt was canceled, all or part of the canceled debt may be excludable from income.
 - **Cases involving bankruptcy or insolvency are OUT OF SCOPE...**
- The preparer needs to ask taxpayer if they were in bankruptcy or might have been insolvent immediately before the debt was canceled; if “yes” or “not sure,” we must refer the client to a paid preparer. (OUT OF SCOPE)
- The debt must be personal (i.e. NOT related to a business)
 - **Cases involving business related debt are OUT OF SCOPE...**

Example

Fred runs up \$15,000 in credit card debt and can’t pay. He works out a deal with the credit card company to settle for \$10,000 and the rest of the debt is canceled. Fred was solvent immediately before the debt was canceled. Fred receives a 1099-C from the creditor shown below:

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-1424		2014 Form 1099-C	Cancellation of Debt
CREDITOR’S name, street address, city, state, ZIP code, and telephone no. Big Bank 1 Big Plaza Gotham, DE 11001		1 Date canceled 05/05/2014	2 Amount of debt canceled \$ 5,000.00		
		3 Interest if included in box 2 \$			
CREDITOR’S federal identification number	DEBTOR’S identification number	4 Debt description		Copy B For Debtor <small>This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.</small>	
DEBTOR’S name John Doe					
Street address (including apt. no.) 123 Elm St		5 Was borrower personally liable for repayment of the debt? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No			
City, state, and ZIP code Anytown, YS 12345					
Account number (see instructions)		6 Bankruptcy (if checked) <input type="checkbox"/>	7 Fair market value of property \$		
Form 1099-C		(keep for your records)		Department of the Treasury - Internal Revenue Service	

The consequence is \$5,000 of taxable income which is reported on the 1040, line 21, other income, as CANCELLED DEBT.

In TWO, go to line 21 and link to “1040 Wkt7 Other Income Worksheet for 1040 Line 21”. Enter the words “CANCELLED DEBT INCOME” in the DESCRIBE field on line 16 of this form. Enter \$5,000 in the AMOUNT field. If there is already income entered on this line, use the next line available. TaxWise will put the amount(s) entered on Wkt 7 on Line 21 as other income.

IMPORTANT NOTE: 1099-C Income is NOT taxable in NJ, but TW will carry the federal 1040, line 21 amount to NJ-1040 line 25. Remember to remove the corresponding amount from NJ-1040, line 25 (Other Income). Enter a negative amount equal to the COD amount on Line F of “Supplementary Schedule of Other Income” that can be linked from line 25 of the NJ 1040.