

BANKRUPTCY BEAGLE

SNIFFING OUT THE BEST FREE AND LOW COST INFORMATION ABOUT BANKRUPTCY.



Settle Student Loan Debt, Will I Pay Income Tax?

Question:

I previously filed chapter 7 bankruptcy and included my private loans; I know the student loans were not discharged, but if I settle those student loans now, might I owe tax on the unpaid amount. Thank you.

Answer:

Private student loans are still a live debt after bankruptcy; if you settle private student loans after bankruptcy, the IRS treats the unpaid portion as taxable income (referred to as Forgiven Debt Income) and you may be liable to pay tax on that settled debt unless you qualify for an exception.

Student loans, even private student loans, are non-dischargeable in bankruptcy unless the debtor proves (in an Adversary Proceeding in bankruptcy court) that repaying the debt would create an undue hardship. After your bankruptcy is complete, the student loans become a live debt. If you later settle your private student loans, the unpaid portion is subject to Forgive Debt Income Tax liability.

Normally, a debt *discharged* in bankruptcy is excepted from Forgiven Debt Income Tax; bankruptcy is box 1a on [IRS Form 982](#). So, if you discharged \$40,000 in credit card debt, you will not be liable to pay income tax on that \$40,000 of discharged debt. However, the bankruptcy exception is not available for debt that survives bankruptcy (not discharged), and student loans are non-dischargeable debt.

The only other exception from paying tax for settled private student loan debt is the general insolvency exception (box 1b on IRS Form 982). If the taxpayer is insolvent at the time the debt is settled, then the taxpayer is excepted from paying tax on forgiven student loan debt. To determine if you are insolvent, you will need to complete the [IRS Insolvency Worksheet](#). You must prove insolvency at the time the debt is settled.

About Bankruptcy Beagle:

Bankruptcy Beagle is the consumers' companion in finding accurate, reliable, free and low cost information about debt and bankruptcy.

Bankruptcy Beagle is an attorney's companion in expertise marketing. We are a tool for attorneys to demonstrate their expertise and attract more clients. We publish attorney written material on our portfolio of websites and publish books written by attorneys.

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If you successfully settle your private student loans, at some point the loan servicer will send you a [1099-C](#). The 1099-C is a reporting document very similar to the W-2 you receive from your employer at tax time; the 1099-C will indicate that amount of debt the lender forgave. For example, if you owed \$20,000 and settled for \$5,000, the 1099-C (box 2) will show \$15,000 (the unpaid or settled amount). When it comes time to do your taxes you will need to complete IRS Form 982. If you qualify as insolvent, you will not include the forgiven debt as income, if you do not qualify as insolvent, you will include the forgiven amount as income and be liable for the appropriate tax.

So, if you settle student loan debt after bankruptcy, you will not be able to use the bankruptcy exception to Forgiven Debt Income Tax, but you might still qualify for the insolvency exception. In any event, when settling private student loan debt, you must take into consideration the potential tax consequences.

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