



OFFICE OF THE CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

May 3, 2010

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CC:ITA:B04:
CONEX-116329-10

UIL: 61.22-00

The Honorable Amy Klobuchar
United States Senate
Washington, DC 20510

Dear Senator Klobuchar:

I am responding to your letter of March 30, 2010, on behalf of your constituent,
. He asked why money that he could not pay to his credit card
company is income to him for federal income tax purposes.

As you requested, I responded directly to . I am enclosing a copy of my
response.

I hope this information is helpful. If you need further assistance, please call me or
at .

Sincerely,

Michael J. Montemurro
Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosure



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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May 3, 2010

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UIL: 61.22-00

Dear _____ :

I am responding to your inquiry of July 7, 2009, to Senator Amy Klobuchar, who asked me to respond directly to you. You asked why money that you could not pay back to your credit card company is considered income for federal income tax purposes. I hope the following general information is helpful.

Congress has provided that gross income includes all income from whatever source derived, including income from discharge of indebtedness (section 61(a)(12) of the Internal Revenue Code (Code)).

A taxpayer who receives a cash payment generally must include it in income. By contrast, a taxpayer who receives cash through a loan does not recognize the receipt of the cash as income because the taxpayer has an offsetting obligation to repay the cash. If, however, the taxpayer's obligation to repay the cash is cancelled (either formally or constructively through noncollection), the taxpayer has income because the reason for excluding the receipt of the cash from income (that is, the obligation to repay), no longer exists.

A taxpayer who purchases property with a credit card is like a taxpayer who purchases property with proceeds of a cash loan. Thus, a taxpayer who buys property on credit does not include the value of the property in income because the taxpayer has an offsetting obligation to pay the credit card company for the extension of credit (that is, the loan). If the credit card company later cancels the taxpayer's obligation to repay the credit extended, then the taxpayer must recognize the income at the time of the cancellation.

Congress, however, has provided certain exclusions for discharge of indebtedness income. For example, a debtor who is insolvent immediately before the discharge of the debt can exclude discharge of indebtedness income to the extent he or she is insolvent (section 108(a)(1)(B) of the Code). A taxpayer is insolvent to the extent that his or her liabilities exceed the fair market value of his or her assets (section 108(d)(3)).

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If you have any questions, please contact _____, Identification Number _____, at _____.

Sincerely,

Michael J. Montemurro
Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

Cc: The Honorable Amy Klobuchar