

Issues in Partnership Discharge of Indebtedness – IRC § 108

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Introduction



Basic Principles

- ❖ IRC § 61(a)(12) provides that “income from discharge of indebtedness” is includable in gross income.
- ❖ IRC § 108(a)(1) provides generally that gross income does not include COD income if:
 - the discharge occurs in a bankruptcy case, or
 - the discharge occurs when taxpayer is insolvent.

General Types of Liabilities

- ❖ Recourse liability:
 - The taxpayer is personally liable for repayment of the debt.
 - The lender may pursue collection on all or part of the outstanding balance in the event of default.
- ❖ Nonrecourse liability:
 - The taxpayer is not personally liable.
 - The lender cannot pursue the taxpayer for any outstanding balance in the event of default.

Partner or Partnership Bankruptcy Example

- ❖ XYZ Partnership files for Chapter 11 bankruptcy on December 4, 2012. At the time of filing, XYZ is insolvent. As part of the final bankruptcy order \$100,000 of XYZ's debts are discharged
- ❖ This result in \$100,000 of COD income to XYZ.
- ❖ Any available exclusion is determined at the partner level.
 - This may result in one partner excluding all or part of the COD income while another partner may pay tax on his allocable share of the COD income.

Insolvency Exclusion



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