Standard Federal Tax Reporter (2018), Regulation, §1.61-12., Internal Revenue Service, Income from discharge of indebtedness

Reg. §1.61-12 does not reflect recent law changes. For details, see ¶5801.01.

(a) *In general.*— The discharge of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, the debtor realizes income in the amount of the debt as compensation for his services. A taxpayer may realize income by the payment or purchase of his obligations at less than their face value. In general, if a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation to the extent of the principal of the debt.

(b) *Proceedings under Bankruptcy Act*  
(1) Income is not realized by a taxpayer by virtue of the discharge, under section 14 of the Bankruptcy Act (11 U.S.C. 32), of his indebtedness as the result of an adjudication in bankruptcy, or by virtue of an agreement among his creditors not consummated under any provision of the Bankruptcy Act, if immediately thereafter the taxpayer's liabilities exceed the value of his assets. Furthermore, unless one of the principal purposes of seeking a confirmation under the Bankruptcy Act is the avoidance of income tax, income is not realized by a taxpayer in the case of a cancellation or reduction of his indebtedness under—

(i) A plan of a corporate reorganization confirmed under Chapter X of the Bankruptcy Act (11 U.S.C., ch. 10);

(ii) An "arrangement" or a "real property arrangement" confirmed under Chapter XI or XII, respectively, of the Bankruptcy Act (11 U.S.C., ch. 11, 12); or

(iii) A "wage earner's plan" confirmed under Chapter XIII of the Bankruptcy Act (11 U.S.C., ch. 13).

(2) For adjustment of basis of certain property in the case of cancellation or reduction of indebtedness resulting from a proceeding under the Bankruptcy Act, see the regulations under section 1016.

(c) *Issuance and repurchase of debt instruments*  
(1) **Issuance.**— An issuer does not realize gain or loss upon the issuance of a debt instrument. For rules relating to an issuer's interest deduction for a debt instrument issued with bond issuance premium, see § 1.163-13.

(2) **Repurchase**  
(i) *In general.*— An issuer does not realize gain or loss upon the repurchase of a debt instrument. However, if a debt instrument provides for payments denominated in, or determined by reference to, a nonfunctional currency, an issuer may realize a currency gain or loss upon the repurchase of the instrument. See section 988 and the regulations thereunder. For purposes of this paragraph (c)(2), the term *repurchase* includes the retirement of a debt instrument, the conversion of a debt instrument into stock of the issuer, and the exchange (including an exchange under section 1001) of a newly issued debt instrument for an existing debt instrument.

(ii) **Repurchase at a discount.**— An issuer realizes income from the discharge of indebtedness upon the repurchase of a debt instrument for an amount less than its adjusted issue price (within the meaning of § 1.1275-1(b)). The amount of discharge of indebtedness income is equal to the excess of the adjusted issue price over the repurchase price. See section 108 and the regulations thereunder for additional rules relating to income from discharge of indebtedness. For example, to determine
the repurchase price of a debt instrument that is repurchased through the issuance of a new debt instrument, see section 108(e)(10).

(iii) Repurchase at a premium.— An issuer may be entitled to a repurchase premium deduction upon the repurchase of a debt instrument for an amount greater than its adjusted issue price (within the meaning of § 1.1275-1(b)). See § 1.163-7(c) for the treatment of repurchase premium.

(iv) Effective date.— This paragraph (c)(2) applies to debt instruments repurchased on or after March 2, 1998.

(d) Cross references.— For exclusion from gross income of—

(1) Income from discharge of indebtedness in certain cases, see sections 108 and 1017, and regulations thereunder;

(2) Forgiveness of Government payments to encourage exploration, development, and mining for defense purposes, see section 621 and regulations thereunder.

(e) Cross reference.— For rules relating to the treatment of liabilities on the sale or other disposition of encumbered property, see § 1.1001-2. [Reg. §1.61-12.]