

Bookkeeping Tips

Booking Cancelled Debts

Generally, if your company's debt is forgiven, you must include the cancelled amount in gross income for tax purposes. An exception is made for debt cancellations to the extent that the payment would have been a deduction.

Example: Your company obtains legal services on credit. Then your firm has trouble paying its debts, but is neither bankrupt nor insolvent. Your law firm forgives part your legal services bill. How you book the cancellation depends on your method of accounting:

Accrual-basis firms must include cancellation of the debt as income because, under the accrual method, expenses are recognized when incurred, not when paid.

Cash-basis firms do not include the debt cancellation in income because payment for the services would have been a deductible business expense.

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