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Loans Aren't Taxed By IRS, But Disguised 'Loans' Can Be Criminal



Suppose that your uncle loans you \$10,000 to tide you over, is it taxable income? No, it shouldn't be, since you have to pay it back. What about when the bank loans you \$100,000? No again, you have to pay it back, so it does not count as income, provided it's a real loan. That's a key distinction that lands

lots of taxpayers in trouble. But even if it's a real loan and is later forgiven, it is income *then*. That tax on forgiveness is called [cancellation of debt income](#), often shortened to COD income. You got cash when you borrowed the money. When you don't have to repay it, that cash is no longer loan proceeds and becomes income.

If you receive a loan, can the IRS claim the "loan" you received really wasn't a loan at all? Yes, the IRS can say that, and the issue comes up more frequently than you might think. Take the case of a Minnesota CPA, David V. Erickson, who was recently indicted for tax evasion, assisting in the preparation of false tax returns and making false statements to federal agents. The indictment is only an accusation, and that the government must prove their case to convict. The charges are based in part on the age-old line between real loans and loans that seem to be "loans" in name only.

According to [the Department of Justice release](#) and the indictment, from 2014 through 2018, David V. Erickson, a licensed CPA, engaged in a scheme to conceal from the IRS income that he earned abroad by falsely characterizing the funds he received as loans. Erickson allegedly owned and operated Halstead Bay Holdings (HBH), a Minnesota-based consulting company. HBH allegedly received payments from several foreign companies that Erickson partially owned. These foreign companies allegedly provided marketing and payment processing systems for an adult content website.

The feds have alleged that Erickson caused his foreign companies to transfer millions of dollars held offshore to bank accounts in the United States that he controlled. He allegedly directed his bookkeeper and others to falsely characterize those payments as nontaxable loans in HBH's accounting records. HBH's purported debt allegedly grew to nearly \$5 million by the end

of 2018. The indictment claims that Erickson used the funds for personal expenses, including the purchase of a \$1.3 million home and a luxury vehicle.

A [Department of Justice](#) statement notes the allegations that Erickson provided false information to his accountants and bookkeepers, and, in turn, filed false [federal income tax](#) returns with the IRS. Erickson also allegedly lied to IRS Criminal Investigation special agents by claiming he had no authority to direct the foreign companies to send money. If convicted, he faces a maximum penalty of five years in prison for each tax evasion count and for making a false statement to IRS-CI agents and three years in prison for each count of assisting in the preparation of false tax returns.

Most loan vs. income questions are less exotic and less consequential too. Still, many taxpayers face the key question of when payments are income, and when they are loans. Most people know this distinction—if you agree to pay it back in writing, that sounds like a loan. Yet even if a loan is a bona fide loan and therefore not income, it might turn into income later. The tax code generally taxes you when you are relieved of paying back a debt, treating it like cash paid to you.

This unpleasant rule might seem easy to ignore, except that when a loan is forgiven, you'll generally receive a [Form 1099-C](#) reporting income to you—and telling the IRS. If you receive one and disagree with the amount shown, write the lender requesting a corrected [Form 1099-C](#) showing the proper amount of cancelled debt. Don't ignore [Forms 1099](#). In some cases, COD income isn't taxed. If you believe the cancelled debt isn't income because you're insolvent or for any other reason, you'll need to address this on your return.

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