



2023 Annual Conference Cancellation of Debt

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Objectives



- At the end of this course, you will be able to:
- Explain the reporting of Forms 1099-A and 1099-C
- Identify the deemed selling price from Form 1099-A
- Determine taxable income from cancellation of debt
- Discuss the concept of insolvency
- Complete Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness*

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Types of Debt



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Different Flavors of Debt



- Secured debt
 - The debt is “secured” by specific property, typically real property
 - Borrower is not liable for any debt not settled by repossession of the property
- Unsecured debt
 - Essentially a “signature loan”
 - No specific property is pledged as security for the loan
 - Borrower is fully liable to pay the entire debt

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Non-Recourse Debt



- This is always secured debt.
- Loan is fully satisfied if property is repossessed EVEN IF THE VALUE OF THE PROPERTY HAS DROPPED BELOW THE AMOUNT OF THE DEBT!!
- Thus, the creditor runs the risk of losing money
 - Which means a higher interest rate may be charged

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Non-Recourse Debt



- If loan is non-recourse, this will be stated in the paperwork
- Usually occurs only because required by state law!
- 12 states require the **first mortgage** on taxpayer's principal residence to be non-recourse
- This benefit is LOST when the taxpayer refinances the house
- May also occur with large commercial real estate or large development projects

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Example of Non-Recourse Debt



- Taxpayer takes out a non-recourse mortgage on a building with FMV of \$700,000.
- Mortgage is \$600,000.
- A year later, the taxpayer stops making mortgage payments.
- Loan balance is now \$550,000 and FMV of the building is \$500,000 ..
- Lender repossess the property and later sells the building for \$525,000.
- The lender has lost \$25,000 but cannot pursue the taxpayer for the remainder of the loan.
 - No cancellation of debt income for the taxpayer!

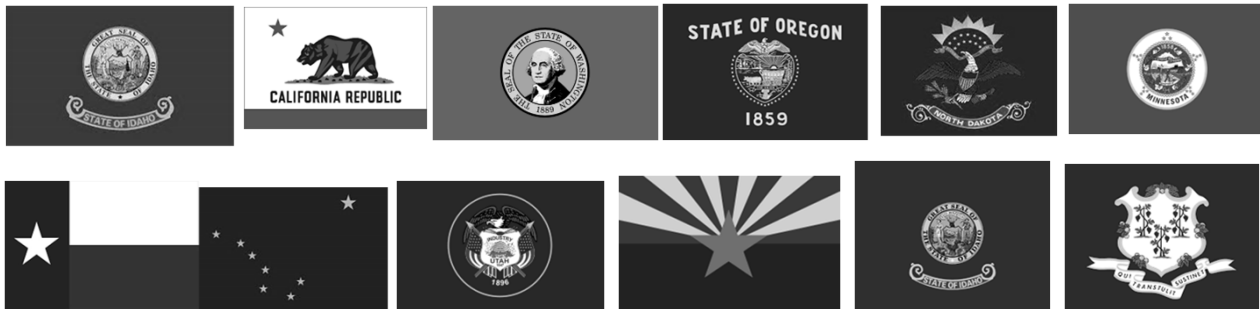
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Twelve States



- These are the 12 states that **require** the first mortgage on a principal residence to be NON-RECOURSE!
- Alaska, Arizona, California, Connecticut, Idaho, Minnesota, North Carolina, North Dakota, Oregon, Texas, Utah and Washington



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Recourse Debt



- Recourse debt may be secured or unsecured.
- Borrower is fully responsible for satisfying the debt, whether or not there is secured property.
- If it's secured, first the property is repossessed...and then the lender can go after the borrower if there is still outstanding debt.

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Debt Comparison



	Recourse debt	Nonrecourse debt
Secured debt	Specific property is pledged as collateral. Lender has recourse to pursue the borrower for remaining debt. Repossession is treated as a sale of property and cancellation of debt may occur.	Specific property is pledged as collateral and lender has no further recourse. Repossession is treated as a sale of the property. No cancellation of debt.
Unsecured debt	"Signature loan" relies on borrower's creditworthiness and promise to repay (credit cards, typically). There is no repossession of property. Cancellation of debt may occur.	NA

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Defaulting on a Loan



- Repossession is not automatic (because the lender really doesn't want the property)!
- There are alternatives:
 - Renegotiate to reduce interest rate, reduce principal balance, extend repayment period, request a temporary halt to required payments
- Principal balance reduction can result in cancellation of debt income to the taxpayer.

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Short Sale



- A short sale occurs when the FMV of the property is less than the mortgage balance, but the lender permits the borrower to sell the property at a price below the balance of the loan.
- Funds received for this sale go directly to the bank.
- May relieve the borrower of further obligation to pay the loan!
- (Or not.)

Whether or not the borrower is relieved of further obligation to pay the loan depends on whether the loan is...??



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Other Options



- Borrower might simply abandon the property.
- Borrower might provide a deed-in-lieu of foreclosure.
 - This is a legal process in which the borrower voluntarily conveys ownership of the home to the lender as an alternative to foreclosure.
 - Note that a deed-in-lieu does not wipe out any secondary loans but lender takes title subject to these liens.
 - Lender is not required to accept the deed-in-lieu.
- State law determines many of the steps in this process.

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QUIZ



- Which of the following is true about nonrecourse debt?
 - a. The lender cannot go after the borrower if the debt is not fully satisfied by property repossession.
 - b. It is never secured debt.
 - c. Some states require the first mortgage on a home to be nonrecourse.
 - d. It will always produce cancellation of debt upon default.

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Form 1099-A



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1099-A



- 1099-A is filed only by a creditor when...
 - That creditor is in the trade or business of lending money AND
 - Debt was secured by property of the borrower AND
 - Creditor receives an interest in the secured property in full or partial satisfaction of the debt
- Due by January 31st of year following the repossession/abandonment

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1099-A NOT Required



- 1099-A is NOT issued in a short sale situation because the lender never takes possession of the property.
 - Instead, there will be a closing document and a 1099-S from the title company!
- 1099-A is NOT issued if the property securing the loan is located outside the United States and the borrower has provided a statement, under penalties of perjury, that the borrower is an exempt foreign person.

1099-A



Identity information	<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0877 Form 1099-A (Rev. January 2022) For calendar year 20__		Acquisition or Abandonment of Secured Property	Date lender acquired the property OR had knowledge of abandonment	
	LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Date of lender's acquisition or knowledge of abandonment			2 Balance of principal outstanding	Balance of mortgage as of that date
	LENDER'S TIN	BORROWER'S TIN	3		4 Fair market value of property	Property FMV as of that date	
	BORROWER'S name		5 If checked, the borrower was personally liable for repayment of the debt <input type="checkbox"/>		6 Description of property		Check the box for recourse!
	Street address (including apt. no.)		6		penalty or other sanction may be imposed on you if income results from this transaction and the IRS determines that it has not been reported.		Property ID
	City or town, state or province, country, and ZIP or foreign postal code		6		This is important tax information and is being furnished to the IRS. If you are required to file a return, you must file a copy of this form with your return.		
Account number (see instructions)		6		Form 1099-A (Rev. 1-2022) (keep for your records) www.irs.gov/Form1099A Department of the Treasury - Internal Revenue Service			

Box 5

- Box 5 establishes whether the debt was recourse or non-recourse
- If it's not checked, it's nonrecourse – the deemed sales price is the loan balance (Box 2).
- If it is checked, then it's recourse – the deemed sales price is the lower of FMV (Box 4) or loan balance (Box 2).

5 If checked, the borrower was personally liable for repayment of the debt

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What If I Don't Agree With the FMV??

- The FMV on Form 1099-A is an important number and is determined by the lender.
 - The difference between the FMV and the debt is collectible by the lender if this is a recourse loan!
 - This FMV also *may* represent a deemed sale amount on the tax return.
- If the borrower doesn't agree with the amount in Box 4, consider getting an appraisal to send to the lender.
- If the lender won't agree, submit the appraisal with Form 8275, *Disclosure Statement*.

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Box 6

- Typically a street address for residential real property
- Vacant land will show a legal address
- Automobile will show a VIN

6 Description of property

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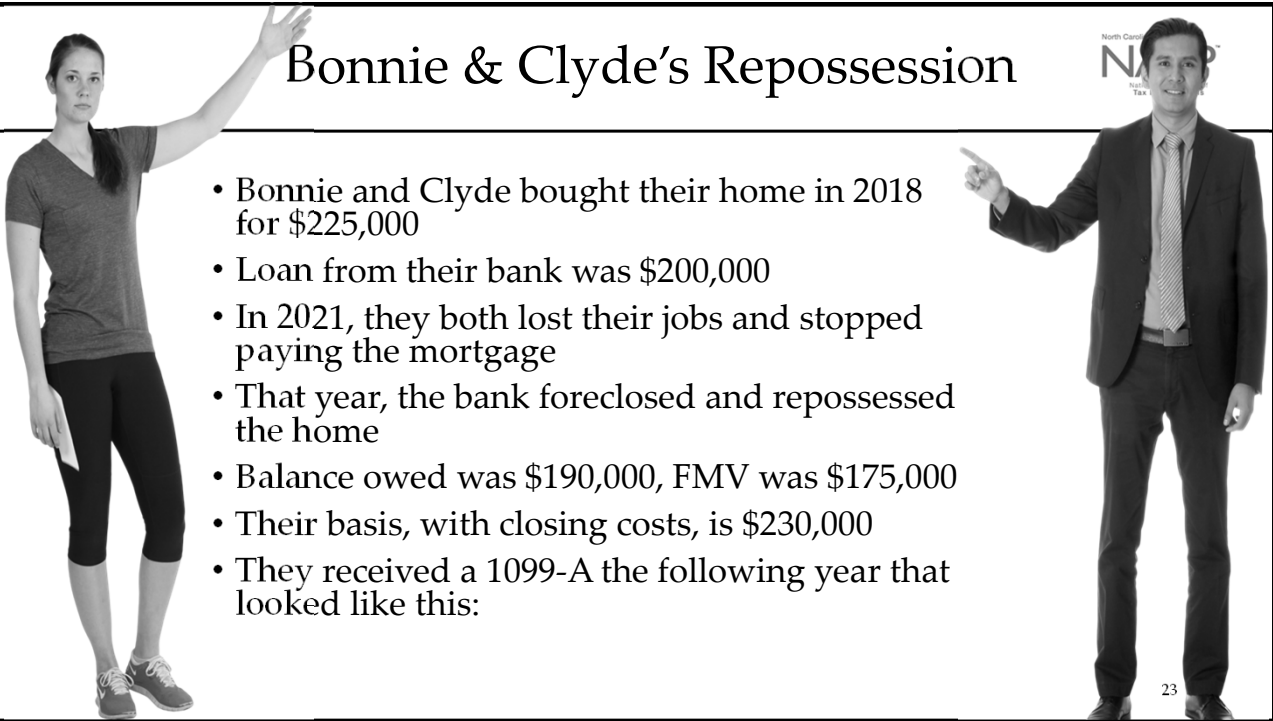
Two Separate Transactions

- Remember that there are two possible tax events when it comes to a repossession of property
- First: the “sale” of the property with a resulting gain or loss
 - (Which may or may not be **recognized** on the tax return)
- Second: the possibility of cancelled debt
- These two tax events may occur in different years

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Bonnie & Clyde's Repossession



- Bonnie and Clyde bought their home in 2018 for \$225,000
- Loan from their bank was \$200,000
- In 2021, they both lost their jobs and stopped paying the mortgage
- That year, the bank foreclosed and repossessed the home
- Balance owed was \$190,000, FMV was \$175,000
- Their basis, with closing costs, is \$230,000
- They received a 1099-A the following year that looked like this:

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Bonnie & Clyde's 1099-A



CORRECTED (if checked)

LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		OMB No. 1545-0877		Acquisition or Abandonment of Secured Property
MORTGAGE BANK		Form 1099-A (Rev. January 2022) For calendar year 20 <u>22</u>		
LENDER'S TIN	BORROWER'S TIN	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding	Copy B For Borrower This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.
XXX-XX-XXXX	123-45-6789	12/5/2021	\$ 190,000	
BORROWER'S name		3	4 Fair market value of property	
BONNIE AND CLYDE			\$ 175,000	
Street address (including apt. no.)		5 If checked, the borrower was personally liable for repayment of the debt <input checked="" type="checkbox"/>		
City or town, state or province, country, and ZIP or foreign postal code		6 Description of property		
Account number (see instructions)		1234 ARROWHEAD DRIVE TOMBSTONE, AZ		

Form **1099-A** (Rev. 1-2022) (keep for your records) www.irs.gov/Form1099A Department of the Treasury - Internal Revenue Service

Loan balance \$190K

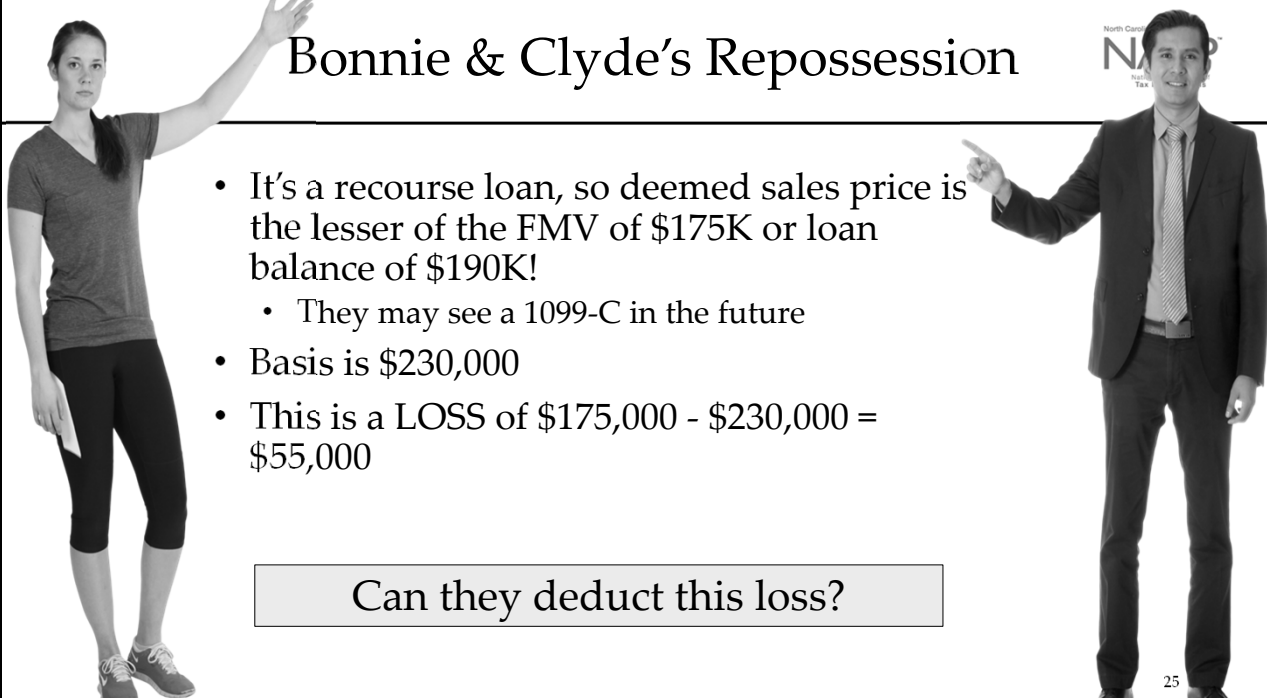
FMV \$175K

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Bonnie & Clyde's Repossession

- It's a recourse loan, so deemed sales price is the lesser of the FMV of \$175K or loan balance of \$190K!
 - They may see a 1099-C in the future
- Basis is \$230,000
- This is a LOSS of $\$175,000 - \$230,000 = \$55,000$

Can they deduct this loss?



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Bonnie & Clyde's Repossession

Form 8949 (2022) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side Social security number or taxpayer identification number
 BONNIE AND CLYDE XXXX-XX-XXXX

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

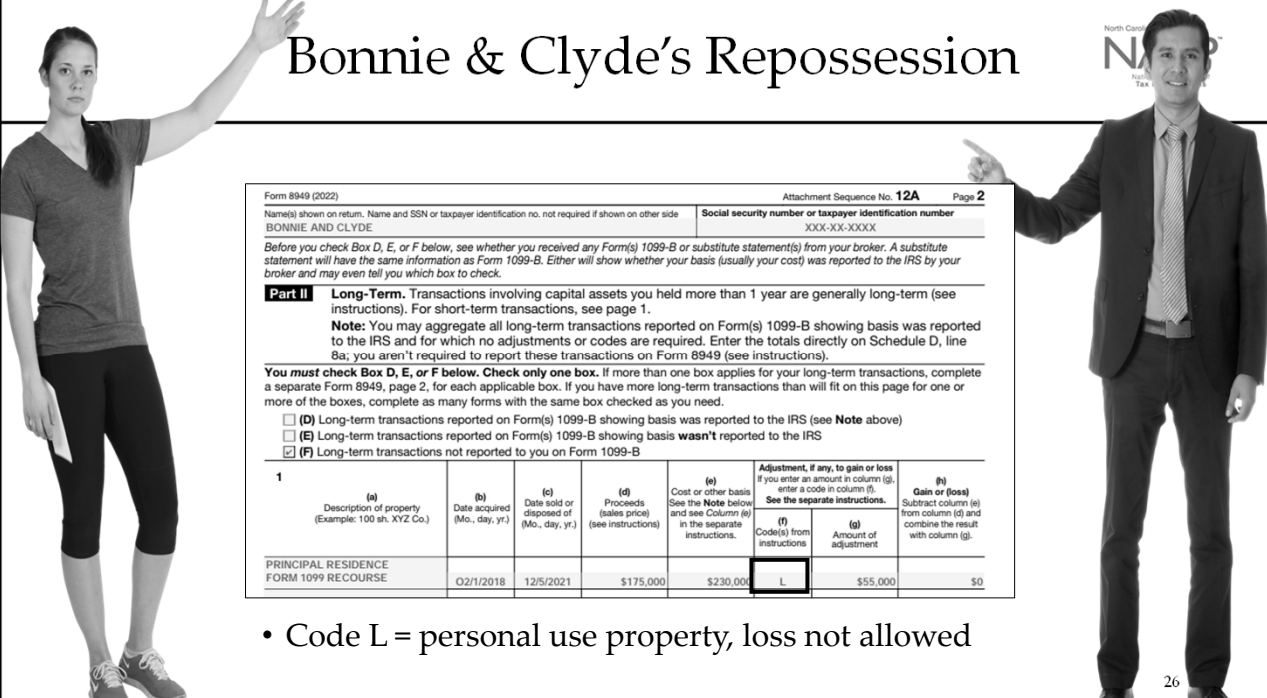
Part II Long-Term. Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.
Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You must check Box D, E, or F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

(D) Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see Note above)
 (E) Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
 (F) Long-term transactions not reported to you on Form 1099-B

1	(a) Description of property (Example: 100 sq. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis (See the Note below and see Column (d)) (see instructions)	Adjustment, if any, to gain or loss if you enter an amount in column (g), enter a code in column (f). See the separate instructions.		(h) Gain or (loss) Subtract column (g) from column (d) and combine the result with column (e).
						(f) Code(s) from instructions	(g) Amount of adjustment	
	PRINCIPAL RESIDENCE FORM 1099 RECOURSE	02/1/2018	12/5/2021	\$175,000	\$230,000	L	\$55,000	\$0

- Code L = personal use property, loss not allowed



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What If There Had Been a Gain?



- In an alternate universe, Bonnie and Clyde's basis was \$150,000 and the deemed sale price was \$175,000, so they have a gain in that universe.

Form 8949 (2022) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side
BONNIE AND CLYDE Social security number or taxpayer identification number
 XXX-XX-XXXX

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 (F) Long-term transactions not reported to you on Form 1099-B

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						(f) Code(s) from instructions	(g) Amount of adjustment	
	PRINCIPAL RESIDENCE FORM 1099 RECOURSE	02/1/2018	12/5/2021	\$175,000	\$150,000	H	(\$25,000)	\$0

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A Bad Year in Neverland



- Peter and Wendy bought their home in 2019 for \$225,000, with a bank loan of \$200,000.
- In 2022, they both lost their jobs and stopped paying the mortgage.
- That year, the bank foreclosed and repossessed the home.
- Balance owed was \$190,000, FMV was \$175,000.
- Their basis, with closing costs, was \$230,000.
- They received a 1099-A the following year that looked like this:

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Peter and Wendy Get a 1099-A



- Notice that Box 5 is not checked! Sale price is the loan balance!

CORRECTED (if checked)

LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. MORTGAGE BANK		OMB No. 1545-0877 Form 1099-A (Rev. January 2022) For calendar year 20__		Acquisition or Abandonment of Secured Property
LENDER'S TIN XX-XXXXXX	BORROWER'S TIN 123-45-6789	1 Date of lender's acquisition or knowledge of abandonment 12/5/2021	2 Balance of principal outstanding \$ 190,000	
BORROWER'S name PETER AND WENDY		3	4 Fair market value of property \$ 175,000	Copy B For Borrower This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.
Street address (including apt. no.)		5 If checked, the borrower was personally liable for repayment of the debt <input type="checkbox"/>		
City or town, state or province, country, and ZIP or foreign postal code		6 Description of property 2222 ARROWHEAD DRIVE TOMBSTONE, AZ		
Account number (see instructions)		Form 1099-A (Rev. 1-2022) (keep for your records) www.irs.gov/Form1099A Department of the Treasury - Internal Revenue Service		

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Peter and Wendy's Form 8949



- Nondeductible loss of \$40,000

Form 8949 (2022) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side
PETER AND WENDY Social security number or taxpayer identification number XXX-XX-XXXX

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

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1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the Note below and see Column (g) in the separate instructions.	(f) Code(s) from instructions	(g) Amount of adjustment	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g).
	PRINCIPAL RESIDENCE FORM 1099-A NON RECOURSE	02/1/2019	12/5/2021	\$190,000	\$230,000	L	\$40,000	\$0

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QUIZ



- Which of the following is **not** information provided by the 1099-A?
 - a. If the loan is recourse or non-recourse
 - b. The FMV of the property at the time of repossession
 - c. The date a 1099-C will be issued
 - d. The property description
 - e. The loan balance at the time of repossession

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Form 1099-C



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Cancellation of Debt is Income



- §61 (a) GENERAL DEFINITION
- Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:...
- (11) Income from discharge of indebtedness

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Recourse Debt and Debt Cancellation



- Debt cancellation may or may not occur at the same time or even in the same year as the repossession.
- Debt cancellation occurs if and when the lender's accounting department removes the loan from its books.
- Yes, it can take years...
- And the taxpayer might never see the form because it's been mailed to an old address.



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8 “Identifiable Events”



- 8 identifiable events trigger a creditor’s responsibility to report COD income on Form 1099-C
 1. Discharge of indebtedness under Title 11 (aka bankruptcy)
 2. Cancellation of an indebtedness that renders a debt unenforceable in a receivership, foreclosure or similar proceeding
 3. Cancellation of an indebtedness upon expiration of statute of limitations for collection for an indebtedness
 4. Cancellation of an indebtedness pursuant to election of foreclosure remedies

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8 “Identifiable Events”



- 8 identifiable events trigger a creditor’s responsibility to report COD income on Form 1099-C
 5. Cancellation of an indebtedness that renders a debt unenforceable due to probate
 6. Discharge of indebtedness pursuant to an agreement between an entity and a debtor to discharge indebtedness at less than full consideration
 7. Discharge of indebtedness pursuant to a decision by the creditor or application of a defined policy by the creditor
 8. Financial institution, credit union or certain government agencies at the expiration of the non-payment testing period (as required by law to maintain an accurate balance sheet)

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Identifiable Event Codes



- A = Debt discharged in bankruptcy
- B = Unenforceable debt in receivership, foreclosure or similar proceeding other than bankruptcy in a federal or state court
- C = Statute of limitations or expiration of deficiency period
- D = Statutory cancellation following foreclosure
- E = Unenforceable due to probate or similar proceedings
- F = Agreement between debtor and creditor to cancel
- G = Cancellation decision or policy to discontinue collection
- H = Other actual discharge prior to an identifiable event

Form 1099-C



The diagram shows Form 1099-C (Rev. 1-2022) with several callouts:

- Identity information:** A bracket on the left side encompasses the CREDITOR'S name, address, TIN, and DEBTOR'S name, address, and TIN.
- Date of identifiable event:** Points to Box 1.
- Amount of debt cancelled:** Points to Box 2.
- Any interest included in Box 2:** Points to Box 3.
- Identifiable event code:** Points to Box 6.
- Property FMV:** Points to Box 7.
- Recourse?:** Points to Box 5.
- Type of debt cancelled:** Points to the 'Cancellation of Debt' section.

Other labels include 'CORRECTED (if checked)', 'Form 1099-C', 'Copy B For Debtor', and 'Department of the Treasury - Internal Revenue Service'.

Lizzy and William



- Lizzy and William bought their home in 2020 for \$210,000
- Bank loan (recourse) for \$164,000
- Bank foreclosed and repossessed the house on 12/5/2022
- Loan balance was \$154,000 including \$1,200 interest unpaid
- Home FMV was \$140,000
- William and Lizzy still owe \$14,000 to the bank
- But the bank's policy is to not pursue debts under \$15,000!!

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Lizzy and William's 1099-C



- The bank sends ONE form out, a 1099-C
- No need to send a 1099-A as well

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-1424		Cancellation of Debt
CREDITOR'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. BANK OF EVERYWHERE		1 Date of identifiable event 12/5/2022	Form 1099-C (Rev. January 2022)	
		2 Amount of debt discharged \$ 154,000	3 Interest, if included in box 2 \$ 1,200	For calendar year 20 22
CREDITOR'S TIN XX-XXXXXXX	DEBTOR'S TIN 123-45-6789	4 Debt description RESIDENTIAL MORTGAGE LOAN		Copy B For Debtor This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.
DEBTOR'S name LIZZY AND WILLIAM		5 If checked, the debtor was personally liable for repayment of the debt <input checked="" type="checkbox"/>		
Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		6 Identifiable event code G		
Account number (see instructions)		7 Fair market value of property \$ 140,000		
Form 1099-C (Rev. 1-2022) (keep for your records)		www.irs.gov/Form1099C		Department of the Treasury - Internal Revenue Service

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Only Form 1099-C is Received



- There are still TWO separate reportable events if real property is involved!
 - Repossession aka deemed sale
 - Debt cancellation aka possible ordinary income



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What Do I Do About Interest?



- If the interest would have been deductible if they had paid it, they are not required to pay tax on it as cancelled debt.
- This treatment only applies to **deductible interest**.
- It doesn't matter if they wouldn't have itemized.

SCHEDULE A (Form 1040) <small>Department of the Treasury Internal Revenue Service</small>	Itemized Deductions <small>Go to www.irs.gov/ScheduleA for instructions and the latest information. Attach to Form 1040 or 1040-SR.</small>	<small>OMB No. 1545-0074</small>
		2022 <small>Attachment Sequence No. 07</small>
<small>Name(s) shown on Form 1040 or 1040-SR</small>		<small>Your social security number</small>

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End Result Lizzy and William



- Debt discharged is \$154,000 – FMV \$140,000 – \$1,200 deductible interest = \$12,800 cancelled debt
- But is not taxable thanks to the principal residence mortgage indebtedness exclusion! §108(a)(1)(E)
- (We'll talk more about that shortly)

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Guarantors



- Bob Sr. guaranteed a loan for Bob Jr.

If the Bob, Jr. defaults, who gets the 1099-C?



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1099-C for Credit Cards



- 1099-C is filed by each credit card company.
- A taxpayer may receive multiple 1099-Cs from multiple credit card companies.
- But no property is repossessed so no 1099-A is filed.



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QUIZ



- Which statements are false?
 - a. There must always be both a 1099-A and a 1099-C when there is cancellation of debt.
 - b. In certain cases, a 1099-C is enough; no 1099-A is required.
 - c. If multiple credit card companies cancel debt, the combined amount is reported on just one 1099-C.
 - d. If real property is repossessed under a recourse loan, there will likely be two taxable events: deemed sale and debt cancellation.

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Exceptions



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Exclusions vs Exceptions...

- There are 4 **exceptions** to the rule that cancellation of debt is income.
 - Meaning the taxpayer will not receive a 1099-C in these circumstances...
- There are 5 **exclusions** that require the reduction of tax attributes.
 - Meaning the taxpayer will probably receive a 1099-C in these circumstances but might not have to pay tax on that cancelled debt!



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Start with the 4 Exceptions



- These four exceptions **do not** result in a 1099-C and no tax attributes are reduced on Form 982 (so basically invisible to the IRS)
 - Gifts and bequests §102(a)
 - Forgiveness of tax-deductible items (when the debt itself would be deductible if paid – remember the interest on the mortgage!) §108(e)(2)
 - Direct purchase price reductions between buyer and seller (§108(e)(5)(A))
 - (When seller is holding the note and reduces the price)
 - Certain student loans §108(f)(1), §108(f)(5)

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Gifts and Bequests



- §102 (a) **GENERAL RULE** Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.
- If the debt was cancelled as a gift or inheritance, there is no taxable income to the recipient of that gift.



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Deductible Debt



- If you use the cash method of accounting, you do not realize income from the cancellation of debt if the payment of the debt would have been a deductible expense.
- (Because it just ends up being a wash.)



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Price Reductions



- Direct purchase price reductions between buyer and seller are simply reductions in price.
- No cancellation of debt is involved.



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Student Loan Debt



- §108(f)(1) STUDENT LOANS
- **(1) IN GENERAL**
- In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if such discharge was pursuant to a provision of such loan under which all or part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time in certain professions for any of a broad class of employers.

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Teachers, Doctors, Nurses...



- This exclusion typically applies to people who agree to work in certain fields in underserved areas for a period of time!
 - Typically rural areas
- Organizations include:
 - Public Service Loan Forgiveness
 - National Health Service Corps Loan Repayment Program
 - Indian Health Service Loan Repayment Program
 - Armed Forces Loan Repayment Programs

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Form 982 Exclusions



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Form 982



- “Generally, the amount by which you benefit from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in §108, you can exclude the amount of discharged indebtedness from your gross income.
- You must file Form 982 to report the exclusion and the reduction of certain tax attributes either dollar for dollar or $33\frac{1}{3}$ cents per dollar (as explained later).” - - *Form 982 Instructions*

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Form 982



- “Generally, the amount by which you benefit from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in §108, you can exclude the amount of discharged indebtedness from your gross income.
- You must file Form 982 to report the exclusion and the reduction of certain tax attributes either dollar for dollar or 33¹/₃ cents per dollar (as explained later).” - - *Form 982 Instructions*

5 Exclusions



- Part I of Form 982 shows the 5 exclusions.

The image shows a portion of Form 982, 'Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)'. It highlights Part I, 'General Information', which contains five exclusion categories, each with a checkbox:

- 1** Amount excluded is due to (check applicable box(es)):
 - a** Discharge of indebtedness in a title 11 case
 - b** Discharge of indebtedness to the extent insolvent (not in a title 11 case)
 - c** Discharge of qualified farm indebtedness
 - d** Discharge of qualified real property business indebtedness
 - e** Discharge of qualified principal residence indebtedness (Caution: See instructions before checking this box if debt was discharged after 2017.)

Arrows from callout boxes on the right point to these checkboxes:

- Bankruptcy (points to 'a')
- Insolvency (points to 'b')
- Qualified farm debt (points to 'c')
- Qual real property business debt (points to 'd')
- Qualified home mortgage debt (points to 'e')

Exclusions...and Tax Attributes



- Part II of Form 982 shows tax attributes to be reduced.

Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)	
Enter amount excluded from gross income:	
4 For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4
5 That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5
6 Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6
7 Applied to reduce any general business credit carryover to or from the tax year of the discharge	7
8 Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8
9 Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9
10a Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. DO NOT use in the case of discharge of qualified farm indebtedness	10a
b Applied to reduce the basis of your principal residence. Enter amount here ONLY if line 1e is checked	10b
11 For a discharge of qualified farm indebtedness applied to reduce the basis of:	
a Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5	11a
b Land used or held for use in a trade or business of farming	11b
c Other property used or held for use in a trade or business or for the production of income	11c
12 Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12
13 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13

Reporting Bankruptcy Exclusion



- To show that debt was canceled in a bankruptcy case and is excluded from income, attach Form 982 to the federal income tax return and check the box on line 1a.
- Lines 1b through 1e don't apply to a cancellation that occurs in a title 11 bankruptcy case.
- Enter the total amount of debt canceled in the title 11 bankruptcy case on line 2.
- You must also reduce the client's tax attributes in Part II of Form 982.

Insolvency



- A taxpayer is insolvent if they have more liabilities than assets.
- The test date for insolvency is the date just prior to the date on the 1099-C.
- All liabilities and all assets are included in the calculation, including assets that would otherwise be exempt from bankruptcy or other collection processes.
- Assets are valued at FMV.
- Liabilities are valued at amount due.

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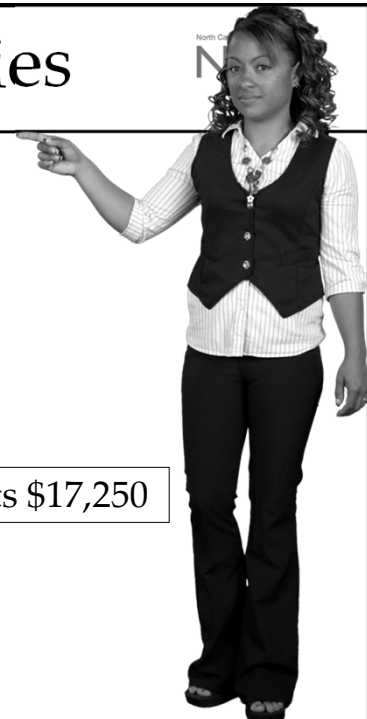
61

Multiple Insolvencies



- Alice had a lot of credit card debt
- She negotiated with the various card companies and was able to reduce both principal and payments on three different cards
- Alice has:
 - Car FMV \$12,000
 - Furniture, jewelry FMV \$5,000
 - Cash of \$250
 - Secured car loan of \$5,000

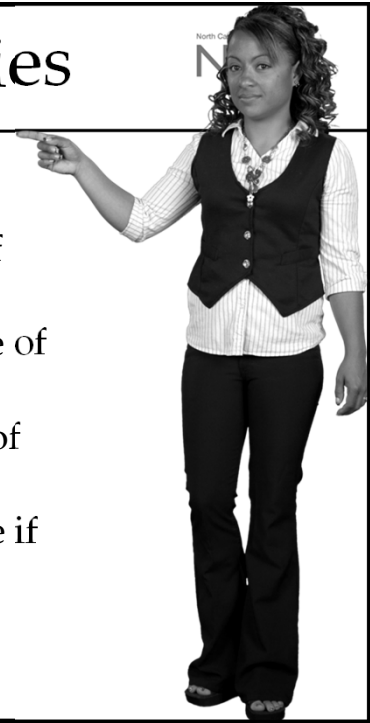
Total assets \$17,250



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Multiple Insolvencies

- Alice received three 1099-C forms:
- First 1099-C is for \$2,235, identifiable event date of 7/15/2022
- Second 1099-C is for \$3,184, identifiable event date of 8/1/2022
- Third 1099-C is for \$1,100, identifiable event date of 8/15/2022
- We have to examine each of these separately to see if Alice meets the insolvency criteria.



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Alice's Liabilities

North Carolina Chapter
NATP
 National Association of
 Tax Professionals

Date	Prior Balance	Post Reduction Balance	Form 1099-C
7/15/2022	\$11,235	\$9,000	\$2,235
8/1/2022	\$6,734	\$3,550	\$3,184
8/15/2022	\$3,450	\$2,350	\$1,100
Total card debt	\$21,419	\$14,900	\$6,519
Car loan	\$5,000	\$5,000	NA
Total debt	\$26,419	\$19,900	NA

- Remember that when debt is cancelled, the liability is removed! So Alice's debts will actually decrease after each 1099-C.
- The car loan amount will also drop if she's making payments, but I've kept that constant for simplicity.

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First 1099-C

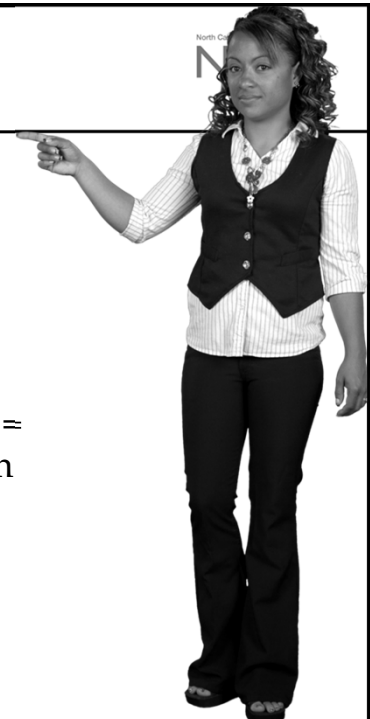
- First 1099-C is for \$2,235 with an identifiable event date of 7/15/2022.
- As of 7/14/2022, Alice has total debt of \$26,419 and assets of \$17,250.
- She is insolvent in the amount of $\$26,419 - \$17,250 = \$9,169$, so that first 1099-C can be excluded from income due to insolvency.



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Second 1099-C

- Second 1099-C is for \$3,184 with an identifiable event date of 8/1/2022.
- As of 7/31/2022, Alice has total debt of $\$9,000 + \$6,734 + \$3,450 + \$5,000 = \$24,184$ and assets of \$17,250.
- She is insolvent in the amount of $\$24,184 - \$17,250 = \$6,934$, so that second 1099-C can be excluded from income due to insolvency.



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Third 1099-C

- Third 1099-C is for \$1,100 with an identifiable event date of 8/15/2022.
- As of 8/14/2022, Alice has total debt of \$9,000 + \$3,550 + \$3,450 + \$5,000 = \$21,000 and assets of \$17,250.
- She is insolvent in the amount of \$21,000 - \$17,250 = \$3,750, so that third 1099-C can be excluded from income due to insolvency.



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IRS Insolvency Worksheet Pub 4681



Insolvency Worksheet		Assets	FMV Immediately Before the Cancellation
Date debt was canceled (mm/dd/yy)		16. Cash and bank account balances	\$
Part I. Total liabilities immediately before the cancellation (don't include the same liability in more than one category)		17. Real property, including the value of land (can be main home, any additional home, or property held for investment or used in a trade or business)	\$
Liabilities (debts)	Amount Owed Immediately Before the Cancellation	18. Cars and other vehicles	\$
1. Credit card debt	\$	19. Computers	\$
2. Mortgage(s) on real property (including first and second mortgages and home equity loans) (mortgage(s) can be on main home, any additional home, or property held for investment or used in a trade or business)	\$	20. Household goods and furnishings (for example, appliances, electronics, furniture, etc.)	\$
3. Car and other vehicle loans	\$	21. Tools	\$
4. Medical bills owed	\$	22. Jewelry	\$
5. Student loans	\$	23. Clothing	\$
6. Accrued or past-due mortgage interest	\$	24. Books	\$
7. Accrued or past-due real estate taxes	\$	25. Stocks and bonds	\$
8. Accrued or past-due utilities (water, gas, electric, etc.)	\$	26. Investments in coins, stamps, paintings, or other collectibles	\$
9. Accrued or past-due childcare costs	\$	27. Firearms, sports, photographic, and other hobby equipment	\$
10. Federal or state income taxes remaining due (for prior tax years)	\$	28. Interest in retirement accounts (IRA accounts, 401(k) accounts, and other retirement accounts)	\$
11. Judgments	\$	29. Interest in a pension plan	\$
12. Business debts (including those owed as a sole proprietor or partner)	\$	30. Interest in education accounts	\$
13. Margin debt on stocks and other debt to purchase or secured by investment assets other than real property	\$	31. Cash value of life insurance	\$
14. Other liabilities (debts) not included above	\$	32. Security deposits with landlords, utilities, and others	\$
15. Total liabilities immediately before the cancellation. Add lines 1 through 14.	\$	33. Interests in partnerships	\$
Part II. Fair market value (FMV) of assets owned immediately before the cancellation (don't include the FMV of the same asset in more than one category)		34. Value of investment in a business	\$
		35. Other investments (for example, annuity contracts, guaranteed investment contracts, mutual funds, commodity accounts, interests in hedge funds, and options)	\$
		36. Other assets not included above	\$
		37. FMV of total assets immediately before the cancellation. Add lines 16 through 36.	\$
		Part III. Insolvency	
		38. Amount of insolvency. Subtract line 37 from line 15. If zero or less, you aren't insolvent.	\$

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What if Alice's COD was More?

- If Alice's COD had exceeded her insolvency and she had no other exclusions available, she would report the excess amount as Schedule 1 income.
- Consider attaching the insolvency worksheets as pdfs to the e-filed tax return.
- Prepare for an audit!!



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Reporting Insolvency Exclusion



- To show that you are excluding canceled debt from income under the insolvency exclusion, attach Form 982 to the federal income tax return and check the box on line 1b.
- On line 2, include the smaller of the amount of the debt canceled or the amount by which you were insolvent immediately before the cancellation.
- Calculate the extent to which the taxpayer was insolvent immediately before the cancellation.
- Taxpayer must also reduce tax attributes in Part II of Form 982.

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Qualified Farm Debt Exclusion



- **§108(g)(2) QUALIFIED FARM INDEBTEDNESS**
- For purposes of this section, indebtedness of a taxpayer shall be treated as qualified farm indebtedness if—
- **(A)** such indebtedness was incurred directly in connection with the operation by the taxpayer of the trade or business of farming, and
- **(B)** 50 percent or more of the aggregate gross receipts of the taxpayer for the 3 taxable years preceding the taxable year in which the discharge of such indebtedness occurs is attributable to the trade or business of farming.

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Qualified Farm Debt Exclusion



- Exclusion limits:
- The amount of canceled qualified farm debt that can be excluded from income under this exclusion is limited. It can't be more than the sum of:
 1. Taxpayer's adjusted tax attributes, plus
 2. The total adjusted basis of qualified property taxpayer held at the beginning of 2022
- Any canceled qualified farm debt that is more than this limit must be included in income.



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Reporting Qualified Farm Debt Exclusion



- To show that all or part of canceled debt is excluded from income because it is qualified farm debt, check the box on line 1c of Form 982 and attach it to Form 1040 or 1040-SR.
- On line 2 of Form 982, include the amount of the qualified farm debt canceled, but not more than the exclusion limit.
- Reduce client's tax attributes in Part II of Form 982



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Qualified Real Property Business Exclusion



- **§108(c)(3) QUALIFIED REAL PROPERTY BUSINESS INDEBTEDNESS**
- The term “qualified real property business indebtedness” means indebtedness which—
- **(A)** was incurred or assumed by the taxpayer in connection with real property used in a trade or business and is secured by such real property,
- **(B)** was incurred or assumed before January 1, 1993, or if incurred or assumed on or after such date, is qualified acquisition indebtedness, and...

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Qualified Real Property Business Exclusion



- **§108(c)(3) QUALIFIED REAL PROPERTY BUSINESS INDEBTEDNESS**
- **(C)** with respect to which such taxpayer makes an election to have this paragraph apply.
- Such term shall not include qualified farm indebtedness. Indebtedness under subparagraph (B) shall include indebtedness resulting from the refinancing of indebtedness under subparagraph (B) (or this sentence), but only to the extent it does not exceed the amount of the indebtedness being refinanced.

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Reporting Real Property Business Exclusion



- Taxpayer must make an election to exclude canceled qualified real property business debt from gross income.
- The election is made on a timely filed federal income tax return (including extensions) and can be revoked only with IRS consent.
- The election is made by completing and attaching Form 982 to your federal income tax return, checking the box on line 1d.
- Include the amount of canceled qualified real property business debt on line 2 of Form 982.
- Reduce tax attributes in Part II of Form 982

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Real Property Business Exclusion Limit



- The excluded amount can't be more than either:
 1. The excess (if any) of the outstanding principal amount of the qualified real property business debt (immediately before the cancellation) over the FMV (immediately before the cancellation) of the business real property securing the debt, or
 2. The total adjusted basis of depreciable real property you held immediately before the cancellation of the qualified real property business debt (other than depreciable real property acquired in contemplation of the cancellation).

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Principal Residence Indebtedness



- Qualified principal residence indebtedness exclusion is:
 - Debt used to buy, build, or improve the taxpayer's principal residence
 - Up to \$1M (\$500K MFS) may be excluded if incurred **on or before** 12/15/2017
 - Up to \$750,000 (\$375K MFS) may be excluded if incurred **after** 12/15/2017
 - Debt must be cancelled before 1/1/2026
 - Exclusion may apply when a taxpayer sells home in a short sale, loses the home in foreclosure, or when mortgage debt is restructured

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Reporting Principal Residence Exclusion



- To show that all or part of your canceled debt is excluded from income because it is qualified principal residence indebtedness, attach Form 982 to the tax return and check the box on line 1e.
- On line 2 of Form 982, include the amount of canceled qualified principal residence indebtedness, but not more than the amount of the exclusion limit.
- **If the taxpayer continues to own the home after a cancellation of qualified principal residence indebtedness, taxpayer's basis in the home must be reduced.**

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Principal Residence Debt

- Brad's principal residence is security for a \$1 million mortgage, of which \$800,000 is qualified principal residence debt and \$200,000 is not.
- Brad cannot afford his mortgage and, due to a decline in market value, he can only sell the home for \$700,000.



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Principal Residence Debt

- The lender agrees to discharge the other \$300,000 of debt (\$1 million – \$700,000).
- Brad may only exclude \$100,000 of discharge of debt income – the total \$300,000 debt discharged less the \$200,000 of debt that is not qualified principal residence debt.
- Brad must report \$200,000 of debt discharge income on his return (\$300,000 debt discharge – \$100,000 excluded from income).



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Didn't Get a 1099-C...



- If the taxpayer thinks debt was canceled but didn't get a form
 - First, of course it's taxable income even if a form wasn't received!
 - BUT don't jump the gun!
 - Could be that the lender is going to issue a 1099-C but hasn't yet done so!

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QUIZ



- True or false?
 - a. Taxpayers only have to reduce tax attributes for the insolvency exclusion.
 - b. All principal residence debt qualifies for the principal residence exception.
 - c. Insolvency is calculated as of the date of the identifiable event.
 - d. Taxpayers may exclude only one 1099-C per year.

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Reducing Tax Attributes



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We Call Them Exclusions...



- But these really are opportunities to DELAY the tax impact!
- If you qualify for one of these 5 exclusions, then you reduce tax attributes to delay the consequences.
- Form 982 reports that tax attribute reduction as required.
- **If your cancelled debt exceeds your tax attributes, the remaining debt is disregarded.**
- If you don't meet any of the exclusions, then you have taxable income.

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Reducing Tax Attributes

- "If you exclude canceled debt from income, you must reduce certain tax attributes (but not below zero) by the amount excluded. Use Part II of Form 982 to reduce your tax attributes."
 - From Pub 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments*



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What's a Tax Attribute?



- A tax attribute is the right to a future tax benefit that is fully vested but is not available to reduce the current year's tax liability.
- Examples: basis in assets (including personal assets), disallowed deductions that carry forward to a future year, credits that carry forward to a future year.

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Tax Attributes



- Tax attributes include:
 1. Any net operating loss and any NOL carryover
 2. Any net capital loss and any capital loss carryover
 3. Any passive activity loss carryover
 4. Three times the sum of any:
 - a. General business credit carryover,
 - b. Minimum tax credit available,
 - c. Foreign tax credit carryover, and
 - d. Passive activity credit carryover

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Form 982 Part II Tax Attributes



Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

4 For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4	
5 That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
6 Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6	
7 Applied to reduce any general business credit carryover to or from the tax year of the discharge	7	
8 Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8	
9 Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9	
10a Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness</i>	10a	
b Applied to reduce the basis of your principal residence. <i>Enter amount here ONLY if line 1e is checked</i>	10b	
11 For a discharge of qualified farm indebtedness applied to reduce the basis of:		
a Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5	11a	
b Land used or held for use in a trade or business of farming	11b	
c Other property used or held for use in a trade or business or for the production of income	11c	
12 Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13	

- Line 4: Used exclusively for the qualified real property business indebtedness exclusions
- Line 5: Taxpayers can make an optional election to reduce tax attributes in an order other than that mandated by §108(b)(1).

Qualified Real Property Business Indebtedness



- Taxpayer reduces the basis of his depreciable real property by the amount excluded. The amount of exclusion allowable as qualified real property business indebtedness is limited to the adjusted basis in these depreciable assets.
- Under this provision, the taxpayer cannot exclude cancellation debt income that (1) exceeds the FMV of the qualified business real estate, or (2) exceeds the adjusted basis of the qualified business real estate.

Form 982 Part II Tax Attributes



Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6	
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge	7	
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8	
9	Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9	
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b	Land used or held for use in a trade or business of farming	11b	
c	Other property used or held for use in a trade or business or for the production of income	11c	
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13	

- Line 6: NOL (reduction is dollar for dollar)
- Line 7: General business credit carryover (reduce credit \$1 for every \$3 of canceled debt)

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Form 982 Part II Tax Attributes



Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
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c	Other property used or held for use in a trade or business or for the production of income	11c	
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13	

- Line 8: Minimum tax credit carryover (reduce credit \$1 for every \$3 of canceled debt)
- Line 9: Net capital loss for the year, plus any capital loss carryovers (reduction is dollar for dollar)

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Form 982 Part II Tax Attributes



Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:

4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
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b	Land used or held for use in a trade or business of farming	11b	
c	Other property used or held for use in a trade or business or for the production of income	11c	
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13	

- Line 10a: Basis in depreciable and nondepreciable (possibly personal) property (but not for qualified farm indebtedness)
- Line 10b: In the situation of qualified principal residence indebtedness, the basis of the taxpayer’s home, but only if the taxpayer maintains possession of it after the discharge.

Personal Use Property



- Personal-use property is any property that isn't used in your trade or business or held for investment (home, home furnishings, car).
- Include on line 10a of Form 982 the smallest of:
 1. The basis of personal-use property held at the beginning of the tax year,
 2. The amount of canceled nonbusiness debt (other than qualified principal residence indebtedness) that is excluded from income on line 2 of Form 982, or
 3. The excess of the total basis of the property and the amount of money held immediately after the cancellation over total liabilities immediately after the cancellation.
- We’ll look at an example shortly!

Qualified Principal Residence Indebtedness



- Acquisition indebtedness is debt the taxpayer incurred to acquire, construct or substantially improve any qualified principal residence that secures the debt.
- Refinanced debt is includable as long as the refinanced loan amount does not exceed the original loan amount.
- The exclusion does not apply to discharges of second mortgages or home equity loans unless the taxpayer used the loans to acquire, construct or substantially improve the taxpayer's principal residence.

Form 982 Part II Tax Attributes



Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:	
4 For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4
5 That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5
6 Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6
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8 Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8
9 Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9
10a Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness.</i>	10a
b Applied to reduce the basis of your principal residence. Enter amount here ONLY if line 1a is checked	10b
11 For a discharge of qualified farm indebtedness applied to reduce the basis of:	
a Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5	11a
b Land used or held for use in a trade or business of farming	11b
c Other property used or held for use in a trade or business or for the production of income	11c
12 Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12
13 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13

- Line 11a-c: Specific issues for farm indebtedness

Form 982 Part II Tax Attributes



Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:		
4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge	7
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8
9	Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9
10a	Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness</i>	10a
b	Applied to reduce the basis of your principal residence. <i>Enter amount here ONLY if line 1e is checked</i>	10b
11	For a discharge of qualified farm indebtedness applied to reduce the basis of:	
a	Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5	11a
b	Land used or held for use in a trade or business of farming	11b
c	Other property used or held for use in a trade or business or for the production of income	11c
12	Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12
13	Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13

- Line 12: Suspended passive activity losses (reduction is dollar for dollar)
- Line 13: Foreign tax credit carryovers (reduce credit by \$1 for every \$3 of canceled debt)

Reduce in Order



- Reduce tax attributes until you run out of debt, or you run out of tax attributes, whichever comes **first!**
- Order of tax attributes reduction:
 1. NOL (dollar for dollar reduction)
 2. General business credit carryover (reduce credit \$1 for every \$3 of cancelled debt)
 3. Minimum tax credit carryover (reduce credit \$1 for every \$3 of cancelled debt)
 4. Net capital loss for the year plus any capital loss carryovers (dollar for dollar reduction)
 5. Property basis
 6. Passive activity loss and credit carryovers
 7. Foreign tax credit

Personal Use Property Example

- In 2020, Diane bought a car for personal use. The cost of the car was \$12,000.
- Diane put down \$2,000 and took out a loan of \$10,000 to buy the car.
- The loan was a recourse loan, meaning that Diane was personally liable for the full amount of the debt.



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Personal Use Property Example

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- On December 7, 2022, when the balance of the loan was \$8,500, the lender repossessed and sold the car because Diane had stopped making payments on the loan.
- The FMV of the car was \$7,000 at the time of repossession.
- The lender applied the \$7,000 it received on the sale of the car against Diane's loan and forgave the remaining loan balance of \$1,500 (\$8,500 outstanding balance immediately before the repossession minus the \$7,000 FMV of the car).

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Personal Use Property Example



- Diane's only other assets as of December 6, 2022 are:
 - Furniture in her apartment with basis of \$5,000 and FMV of \$3,000
 - Jewelry with basis of \$500 and FMV of \$1,000
 - \$600 in her savings account
- Thus, the FMV of Diane's total assets immediately before the cancellation was \$11,600 (\$7,000 car + \$3,000 furniture + \$1,000 jewelry + \$600 savings).

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Personal Use Property Example



- Diane also had an outstanding student loan balance of \$6,000 immediately before the cancellation, bringing her total liabilities at that time to \$14,500.
 - \$8,500 car loan balance + \$6,000 student loan balance = \$14,500 liabilities
- Assets of \$11,600 and liabilities of \$14,500 means Diane is insolvent in the amount of \$2,900.



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Personal Use Property Example



- Diane received a Form 1099-C showing \$1,500 in box 2 (amount of debt that was canceled), \$7,000 in box 7 (FMV of the property), Code G in box 6 showing the debt was cancelled due to lender's policy.
- Diane can exclude all \$1,500 of canceled debt from income because at the time of the cancellation, she was insolvent to the extent of \$2,900.

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Personal Use Property Example



- Diane checks box 1b on Form 982 and enters \$1,500 on line 2.
 - This is the amount she's excluding due to insolvency

was discharged after 2017.) <input type="checkbox"/>	
2 Total amount of discharged indebtedness excluded from gross income	2 \$1,500

- The only tax attribute she has available to reduce is personal property!
- But she doesn't have to reduce her personal property bases by the full \$1,500.
- Here's where it gets weird.

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Reducing Basis in Personal Use Property



- Personal-use property is any property that isn't used in your trade or business or held for investment (home, home furnishings, car).
- Include on line 10a of Form 982 the smallest of:
 1. The basis of personal-use property held at the beginning of the tax year,
 2. The amount of canceled nonbusiness debt (other than qualified principal residence indebtedness) that is excluded from income on line 2 of Form 982, or
 3. The excess of the total basis of the property and the amount of money held immediately after the cancellation over total liabilities immediately after the cancellation.

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Personal Use Property Example



- On line 10a, Diane enters the **smallest** of:
 1. **\$5,500** basis of her personal-use property held at the beginning of 2022 (\$5,000 furniture plus \$500 jewelry), or
 2. **\$1,500** nonbusiness debt she is excluding from income on line 2 of Form 982, or
 3. The **\$100** excess of the total basis of the property and the amount of money Diane held immediately after the cancellation over her total liabilities at that time (\$5,500 basis of property held immediately after the cancellation plus \$600 savings minus \$6,000 student loan).

10a Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness</i>	10a	\$100
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Personal Use Property Example

- Diane must reduce (by one dollar for each dollar of excluded canceled debt) her basis in each item of property she holds at the beginning of 2022 **in proportion to her total adjusted basis in all her property.**
- The total reduction should be \$100.



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Personal Use Property Example

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- Diane reduces her basis pro rata:
 - The furniture's basis is 91% of her total adjusted basis (\$5,000 divided by \$5,500), so she reduces it by \$91 (the \$100 excess multiplied by 0.91).
 - The jewelry's basis is 9% of her total adjusted basis (\$500 divided by \$5,500), so she reduces it by \$9 (the \$100 excess multiplied by 0.09).

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Runnin' Empty on Assets



- §108(b)(2). If the excluded COD income exceeds the sum of the taxpayer's tax attributes, the excess is **permanently excluded** from the taxpayer's gross income.
- Tax attributes are reduced to the lesser of
 - Discharged debt being excluded
 - Total of taxpayer's tax attributes
- Future tax attributes aren't considered!



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Questions?



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