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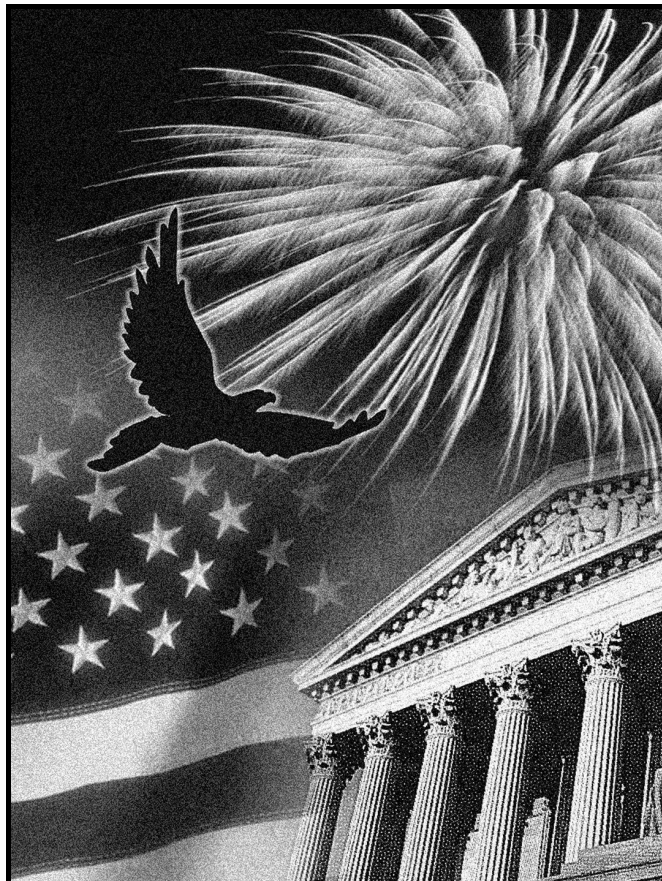
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Canceled Debts, Foreclosures, Repossessions, and Abandonments

(for Individuals)

For use in preparing

2011 Returns



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What's New

Future developments. The IRS has created a page on IRS.gov for information about Publication 4681 at www.irs.gov/pub4681. Information about any future developments affecting Publication 4681 (such as legislation enacted after we release it) will be posted on that page.

Reminder

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that otherwise would be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication explains the federal tax treatment of canceled debts, foreclosures, repossessions, and abandonments.

Generally, if you owe a debt to someone else and they cancel or forgive that debt, you are treated for income tax purposes as having income and may have to pay tax on this income.

Note. This publication refers to the discharge of indebtedness or debt that is canceled or forgiven as “canceled debt.”

Sometimes a debt, or part of a debt, that you do not have to pay is not considered canceled debt. These exceptions are discussed later under [Exceptions](#). And sometimes a canceled debt may be excluded from your income. But, if you do exclude canceled debt from income, you may be required to reduce your “tax attributes.” These exclusions and the reduction of tax attributes are discussed later under [Exclusions](#).

Foreclosure and repossession are remedies that your lender may exercise if you fail to make payments on your loan and you have previously granted that lender a security interest in some of your property. These remedies allow the lender to seize or sell the property securing the loan. When your property is foreclosed upon or repossessed and sold, you are treated as having sold the property and you may recognize taxable gain. Whether you also recognize income from canceled debt depends in part on whether you are personally liable for the debt and whether the outstanding loan balance is more than the fair market value (FMV) of the property. Figuring your gain or loss and canceled debt arising from a foreclosure or repossession is discussed later under [Foreclosures and Repossessions](#).

Generally, you abandon property when you voluntarily and permanently give up possession and use of property you own with the intention of ending your ownership but without passing it on to anyone else. Figuring your gain or loss and canceled debt arising from an abandonment is discussed later under [Abandonments](#).

This publication also includes detailed examples with filled-in forms.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

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Internal Revenue Service
1201 N. Mitsubishi Motorway
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Tax questions. If you have a tax question, check the information available on IRS.gov or call 1-800-829-1040. We cannot answer tax questions sent to either of the above addresses.

Useful Items

You may want to see:

Publication

- 225** Farmer’s Tax Guide
- 334** Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)
- 523** Selling Your Home
- 525** Taxable and Nontaxable Income
- 544** Sales and Other Dispositions of Assets
- 551** Basis of Assets
- 908** Bankruptcy Tax Guide

Form (and Instructions)

- 982** Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

Common Situations Covered In This Publication

The sections of this publication that apply to you depend on the type of debt canceled, the tax attributes you have, and whether or not you continue to own the property that was subject to the debt. Some examples of common circumstances are provided in the following paragraphs to help guide you through this publication. These examples do not cover every canceled debt situation, but are intended to provide general guidance for the most common situations.

Nonbusiness credit card debt cancellation. If you had a nonbusiness credit card debt canceled, you may be able to exclude the canceled debt from income if the cancellation occurred in a title 11 bankruptcy case or you were insolvent immediately before the cancellation. You should read [Bankruptcy](#) or [Insolvency](#) under [Exclusions](#) in chapter 1 to see if you can exclude the canceled debt from income under one of those provisions. If you can exclude part or all of the canceled debt from income, you should also read [Bankruptcy and Insolvency](#) under [Reduction of Tax Attributes](#) in chapter 1.

Personal vehicle repossession. If you had a personal vehicle repossessed and disposed of by the lender during the year, you will need to determine your gain or nondeductible loss on

the disposition. This is explained in [chapter 2](#). If the lender also canceled all or part of the remaining amount of the loan, you may be able to exclude the canceled debt from income if the cancellation occurred in a title 11 bankruptcy case or you were insolvent immediately before the cancellation. You should read [Bankruptcy](#) or [Insolvency](#) under [Exclusions](#) in chapter 1 to see if you can exclude the canceled debt from income under one of those provisions. If you can exclude part or all of the canceled debt from income, you should also read [Bankruptcy and Insolvency](#) under [Reduction of Tax Attributes](#) in chapter 1.

Main home foreclosure or abandonment. If a lender foreclosed on your main home during the year, you will need to determine your gain or loss on the foreclosure. Foreclosures are explained in chapter 2 and abandonments are explained in chapter 3. If the lender also canceled all or part of the remaining amount on the mortgage loan and you were personally liable for the debt, you should also read [Qualified Principal Residence Indebtedness](#) under [Exclusions](#) in chapter 1 to see if you can exclude part or all of the canceled debt from income. Detailed [Example 2](#) and [Example 3](#) in chapter 4 use filled-in forms to help explain these provisions.

Main home loan modification (workout agreement). If a lender agrees to a mortgage loan modification (a “workout”) that includes a reduction in the principal balance of the loan, you should read [Qualified Principal Residence Indebtedness](#) under [Exclusions](#) in chapter 1 to see if you can exclude part or all of the canceled debt from income. If you can exclude part or all of the canceled debt from income, you should also read [Qualified Principal Residence Indebtedness](#) under [Reduction of Tax Attributes](#) in chapter 1. Detailed [Example 1](#) in chapter 4 uses filled-in forms to help explain the tax implications of a mortgage workout scenario.

1.

Canceled Debts

Generally, if a debt for which you are personally liable is canceled or forgiven, other than as a gift or bequest, you must include the canceled amount in your income. However, exceptions to the general rule that canceled debt is included in income may apply. See [Exceptions](#), later. And, even if no exception applies, you still may be allowed to exclude the canceled debt from your income. See [Exclusions](#), later.

A debt includes any indebtedness:

- For which you are liable, or
- Subject to which you hold property.

Debt for which you are personally liable is recourse debt. All other debt is nonrecourse debt.

If you are not personally liable for the debt, you do not have ordinary income from the cancellation of debt unless you retain the collateral and either:

- The lender offers a discount for the early payment of the debt or
- The lender agrees to a loan modification that results in the reduction of the principal balance of the debt.

See [Discounts and loan modifications](#), later. Also, upon the disposition of the property securing a nonrecourse debt, the amount realized includes the entire unpaid amount of the debt, not just the FMV of the property. As a result, you may realize a gain or loss if the outstanding debt immediately before the disposition is more or less than your adjusted basis in the property. For more details on figuring your gain or loss, see [chapter 2](#) of this publication or see Publication 544.

There are several exceptions and exclusions that may result in part or all of a canceled debt being nontaxable. See [Exceptions](#) and [Exclusions](#), later. You must report any taxable canceled debt as ordinary income on:

- Form 1040 or Form 1040NR, line 21, if the debt is a nonbusiness debt;
- Schedule C (Form 1040), line 6 (or Schedule C-EZ (Form 1040), line 1b), if the debt is related to a nonfarm sole proprietorship;
- Schedule E (Form 1040), line 3b, if the debt is related to nonfarm rental of real property;
- Form 4835, line 6, if the debt is related to a farm rental activity for which you use Form 4835 to report farm rental income based on crops or livestock produced by a tenant; or
- Schedule F (Form 1040), line 8b, if the debt is farm debt and you are a farmer.

Form 1099-C. If an applicable entity cancels or forgives a debt you owe of \$600 or more, you will receive a Form 1099-C, Cancellation of Debt. The amount of the canceled debt is shown in box 2. Unless you meet one of the exceptions or exclusions discussed later, this canceled debt is ordinary income and must be reported on the appropriate form shown above.



Even if you did not receive a Form 1099-C, you must report canceled debt as gross income on your tax return unless one of the exceptions or exclusions described later applies.

An applicable entity includes:

- A federal government agency,
- A financial institution,
- A credit union, or
- Any organization a significant trade or business of which is lending money.

Interest included in canceled debt. If any interest is forgiven and included in the amount of canceled debt in box 2, the interest portion that is included in box 2 will be shown in box 3. Whether the interest portion of the canceled debt must be included in your income depends on whether the interest would be deductible if you paid it. See [Deductible Debt](#) under [Exceptions](#), later.

If the interest would not be deductible (such as interest on a personal loan) and you do not

meet any other exception or exclusion discussed later, include in your income the amount from Form 1099-C, box 2. If the interest would be deductible (such as on a business loan) and you do not meet any other exception or exclusion discussed later, include in your income the net amount of the canceled debt (the amount shown in box 2 minus the interest amount shown in box 3).

Discounts and loan modifications. If a lender offers to discount (reduce) the principal balance of a loan if the loan is paid off early, or agrees to a loan modification (a “workout”) that includes a reduction in the principal balance of a loan, the amount of the discount or the amount of principal reduction is canceled debt whether or not you are personally liable for the debt. However, if the debt is nonrecourse and you did not retain the collateral, you do not have cancellation of debt income. The amount of the canceled debt must be included in income unless one of the exceptions or exclusions described later applies. For more details, see [Exceptions](#) and [Exclusions](#), later.

Sales or other dispositions (such as foreclosures and repossessions). If you owned property that was subject to a recourse debt in excess of the FMV of the property, the lender’s foreclosure or repossession of the property is treated as a sale or disposition of the property by you and may result in your realization of gain or loss. If the lender forgives all or part of the amount of the debt in excess of the FMV of the property, the cancellation of the excess debt may result in ordinary income. The gain or loss on the disposition of the property is measured by the difference between the FMV of the property at the time of the disposition and your adjusted basis (usually your cost) in the property. The character of the gain or loss (such as ordinary or capital) is determined by the character of the property. The ordinary income from the cancellation of debt (the excess of the canceled debt over the FMV of the property) must be included in your gross income reported on your tax return unless one of the exceptions or exclusions described later applies. For more details, see [Exceptions](#) and [Exclusions](#), later.

If you owned property that was subject to a nonrecourse debt in excess of the FMV of the property, the lender’s foreclosure on the property does not result in ordinary income from the cancellation of debt. The entire amount of the nonrecourse debt is treated as an amount realized on the disposition of the property. The gain or loss on the disposition of the property is measured by the difference between the total amount realized (the entire amount of the nonrecourse debt plus the amount of cash and the FMV of any property received) and your adjusted basis in the property. The character of the gain or loss is determined by the character of the property.

See Publications 523, 544, and 551, and [chapter 2](#) of this publication for more details.

Abandonments. If the abandoned property secures a debt for which you are personally liable (recourse debt) and the debt is canceled, you will realize ordinary income equal to the canceled debt. You must report this income on your tax return unless one of the exceptions or exclusions described later applies. For more details, see [Exceptions](#) and [Exclusions](#), later. This income is separate from any amount realized

from the abandonment of the property. For more details, see [chapter 3](#).

If the abandoned property secures debt for which you are not personally liable (nonrecourse debt), you may realize gain or loss but will not have cancellation of indebtedness income.

Stockholder debt. If you are a stockholder in a corporation and the corporation cancels or forgives your debt to it, the canceled debt is a constructive distribution that is generally treated as dividend income to you. For more information, see Publication 542, Corporations.

Persons who each receive a Form 1099-C showing the full amount of debt. If you and another person were jointly and severally liable for a debt that is canceled, each of you may get a Form 1099-C showing the entire amount of the canceled debt. However, you may not have to report that entire amount as income. The amount, if any, you must report depends on all the facts and circumstances, including:

- State law,
- The amount of debt proceeds each person received,
- How much of any interest deduction from the debt was claimed by each person,
- How much of the basis of any co-owned property bought with the debt proceeds was allocated to each co-owner, and
- Whether the canceled debt qualifies for any of the exceptions or exclusions described in this publication.

See Example 3 under [Insolvency](#), later.

Exceptions

There are several exceptions to the inclusion of canceled debt in income. These exceptions apply before the exclusions discussed later and do not require you to reduce your tax attributes.

Gifts

Generally, you do not have income from canceled debt if the cancellation or forgiveness of the debt is a gift.

Student Loans

Certain student loans provide that all or part of the debt incurred to attend a qualified educational institution will be canceled if the person who received the loan works for a certain period of time in certain professions for any of a broad class of employers.

If your student loan is canceled as the result of this type of provision, the cancellation of this debt is not included in your gross income. To qualify for this treatment, the loan must have been made by:

1. The federal government, a state or local government, or an instrumentality, agency, or subdivision thereof,
2. A tax-exempt public benefit corporation that has assumed control of a state, county, or municipal hospital, and whose employees are considered public employees under state law, or

3. An educational institution (defined later):
- Under an agreement with an entity described in (1) or (2) that provided the funds to the institution to make the loan, or
 - As part of a program of the institution designed to encourage students to serve in occupations or areas with unmet needs and under which the services provided are for or under the direction of a governmental unit or a tax-exempt section 501(c)(3) organization (defined later).

A loan to refinance a qualified student loan also will qualify if it was made by an educational institution or a tax-exempt section 501(a) organization under its program designed as described in (3)(b) above.

Exception. The cancellation of a student loan made by an educational institution because of services you performed for that institution or another organization that provided funds for the loan must be included in the gross income on your tax return unless one of the other exceptions or exclusions described in this publication applies.

Education loan repayment assistance. Education loan repayments made to you by the National Health Service Corps Loan Repayment Program or a state education loan repayment program eligible for funds under the Public Health Service Act are not taxable if you agree to provide primary health services in health professional shortage areas.

Amounts you received after 2008 under any other state loan repayment or loan forgiveness program also are not taxable if the program is intended to increase the availability of health care services in underserved areas or areas with a shortage of health professionals.

Educational institution. An educational institution is an organization with a regular faculty and curriculum and a regularly enrolled body of students in attendance at the place where the educational activities are carried on.

Section 501(c)(3) organization. A section 501(c)(3) organization is any corporation, community chest, fund, or foundation organized and operated exclusively for one or more of the following purposes.

- Charitable.
- Educational.
- Fostering national or international amateur sports competition (but only if none of the organization's activities involve providing athletic facilities or equipment).
- Literary.
- Preventing cruelty to children or animals.
- Religious.
- Scientific.
- Testing for public safety.

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. This exception applies

before the price reduction exception discussed next.

Example. You get accounting services for your farm on credit. Later, you have trouble paying your farm debts and your accountant forgives part of the amount you owe for the accounting services. How you treat the canceled debt depends on your method of accounting.

- Cash method. You do not include the canceled debt in income because payment of the debt would have been deductible as a business expense.
- Accrual method. Unless another exception or exclusion applies, you must include the canceled debt in ordinary income because the expense was deductible when you incurred the debt.

Price Reduced After Purchase

If debt you owe the seller for the purchase of property is reduced by the seller at a time when you are not insolvent and the reduction does not occur in a title 11 bankruptcy case, the reduction does not result in cancellation of debt income. However, you must reduce your basis in the property by the amount of the reduction of your debt to the seller. The rules that apply to bankruptcy and insolvency are explained in the next section, [Exclusions](#).

Home Affordable Modification Program

Any Pay-for-Performance Success Payments that reduce the principal balance of your home mortgage under the Home Affordable Modification Program are not taxable.

Exclusions

After you have applied any exceptions to the general rule that a canceled debt is included in your income, there are several reasons why you might still be able to exclude a canceled debt from your income. These exclusions are explained next. If a canceled debt is excluded from your income, that means it is nontaxable. Generally, however, if you exclude canceled debt from income under one of these provisions, you must also reduce your tax attributes (certain credits, losses, and basis of assets) as explained later under [Reduction of Tax Attributes](#).



Reacquisition of business debt. If you make an election under section 108(i) of the Internal Revenue Code to defer and ratably include income from the cancellation of business debt arising from the reacquisition of certain business debt repurchased in 2009 and 2010, you cannot exclude that income, for the tax year of the election or any later tax year, based on a title 11 bankruptcy case, insolvency, qualified farm indebtedness, or qualified real property business indebtedness. For more details, see section 108(i) of the Internal Revenue Code and Revenue Procedure 2009-37, 2009-36 I.R.B. 309, available at www.irs.gov/irb/2009-36_IRB/ar07.html.

Bankruptcy

Debt canceled in a title 11 bankruptcy case is not included in your income. A title 11 bankruptcy case is a case under title 11 of the United States Code (including all chapters in title 11 such as chapters 7, 11, and 13), but only if the debtor is under the jurisdiction of the court and the cancellation of the debt is granted by the court or occurs as a result of a plan approved by the court.

How to report the bankruptcy exclusion. To show that your debt was canceled in a bankruptcy case and is excluded from income, attach Form 982 to your federal income tax return and check the box on line 1a. Lines 1b through 1e do not apply to a cancellation that occurs in a title 11 bankruptcy case. Enter the total amount of debt canceled in your title 11 bankruptcy case on line 2. You must also reduce your tax attributes in Part II of Form 982 as explained under [Reduction of Tax Attributes](#), later.

Insolvency

Do not include a canceled debt in income to the extent that you were insolvent immediately before the cancellation. You were insolvent immediately before the cancellation to the extent that the total of all of your liabilities was more than the FMV of all of your assets immediately before the cancellation. For purposes of determining insolvency, assets include the value of everything you own (including assets that serve as collateral for debt and exempt assets which are beyond the reach of your creditors under the law, such as your interest in a pension plan and the value of your retirement account). Liabilities include:

- The entire amount of recourse debts,
- The amount of nonrecourse debt that is not in excess of the FMV of the property that is security for the debt, and
- The amount of nonrecourse debt in excess of the FMV of the property subject to the nonrecourse debt to the extent nonrecourse debt in excess of the FMV of the property subject to the debt is forgiven.



You can use the Insolvency Worksheet, later, to help calculate the extent that you were insolvent immediately before the cancellation.

Note. This exclusion does not apply to a cancellation of debt that occurs in a title 11 bankruptcy case. It also does not apply if the debt is qualified principal residence indebtedness (defined in this section under [Qualified Principal Residence Indebtedness](#), later) unless you elect to apply the insolvency exclusion instead of the qualified principal residence indebtedness exclusion.

How to report the insolvency exclusion. To show that you are excluding canceled debt from income under the insolvency exclusion, attach Form 982 to your 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. You can use the [Insolvency Worksheet](#), later, to help calculate the extent that you were insolvent immediately

before the cancellation. You must also reduce your tax attributes in Part II of Form 982 as explained under [Reduction of Tax Attributes](#), later.

Example 1—amount of insolvency more than canceled debt. In 2011, Greg was released from his obligation to pay his personal credit card debt in the amount of \$5,000. Greg received a 2011 Form 1099-C from his credit card lender showing canceled debt of \$5,000 in box 2. None of the exceptions to the general rule that canceled debt is included in income apply. Greg uses the insolvency worksheet to determine that his total liabilities immediately before the cancellation were \$15,000 and the FMV of his total assets immediately before the cancellation was \$7,000. This means that immediately before the cancellation, Greg was insolvent to the extent of \$8,000 (\$15,000 total liabilities minus \$7,000 FMV of his total assets). Because the amount by which Greg was insolvent immediately before the cancellation was more than the amount of his debt canceled, Greg can exclude the entire \$5,000 canceled debt from income.

When completing his tax return, Greg checks the box on line 1b of Form 982 and enters \$5,000 on line 2. Greg completes Part II to reduce his tax attributes as explained under [Reduction of Tax Attributes](#), later. Greg does not include any of the \$5,000 canceled debt on line 21 of his Form 1040. None of the canceled debt is included in his income.

Example 2—amount of insolvency less than canceled debt. The facts are the same as in Example 1 except that Greg's total liabilities immediately before the cancellation were \$10,000 and the FMV of his total assets immediately before the cancellation was \$7,000. In this case, Greg is insolvent to the extent of \$3,000 (\$10,000 total liabilities minus \$7,000 FMV of his total assets) immediately before the cancellation. Because the amount of the canceled debt was more than the amount by which Greg was insolvent immediately before the cancellation, Greg can exclude only \$3,000 of the \$5,000 canceled debt from income under the insolvency exclusion.

Greg checks the box on line 1b of Form 982 and includes \$3,000 on line 2. Also, Greg completes Part II to reduce his tax attributes as explained under [Reduction of Tax Attributes](#), later. Additionally, Greg must include \$2,000 of canceled debt on line 21 of his Form 1040 (unless another exclusion applies).

Example 3—joint debt and separate returns. In 2011, James and his wife Robin were released from their obligation to pay a debt of \$10,000 for which they were jointly and severally liable. None of the exceptions to the general rule that canceled debt is included in income apply. They incurred the debt (originally \$12,000) to finance James' purchase of a \$9,000 motorcycle and Robin's purchase of a laptop computer and software for personal use for \$3,000. They each received a 2011 Form 1099-C from the bank showing the entire canceled debt of \$10,000 in box 2. Based on the use of the loan proceeds, they agreed that James was responsible for 75% of the debt and Robin was responsible for the remaining 25%. Therefore, James' share of the debt is \$7,500 (75% of \$10,000), and Robin's share is \$2,500 (25% of \$10,000). By

completing the insolvency worksheet, James determines that, immediately before the cancellation of the debt, he was insolvent to the extent of \$5,000 (\$15,000 total liabilities minus \$10,000 FMV of his total assets). He can exclude \$5,000 of his \$7,500 canceled debt. Robin completes a separate insolvency worksheet and determines she was insolvent to the extent of \$4,000 (\$9,000 total liabilities minus \$5,000 FMV of her total assets). She can exclude her entire canceled debt of \$2,500.

When completing his separate tax return, James checks the box on line 1b of Form 982 and enters \$5,000 on line 2. He completes Part II to reduce his tax attributes as explained under [Reduction of Tax Attributes](#), later. He must include the remaining \$2,500 (\$7,500 – \$5,000) of canceled debt on line 21 of his Form 1040 (unless another exclusion applies).

When completing her return, Robin checks the box on line 1b of Form 982 and enters \$2,500 on line 2. She completes Part II to reduce her tax attributes as explained under [Reduction of Tax Attributes](#), later. She does not include any of the canceled debt on line 21 of her Form 1040. None of the canceled debt has to be included in her income.

Qualified Farm Indebtedness

You can exclude canceled farm debt from income if all of the following apply.

- The debt was incurred directly in connection with your operation of the trade or business of farming.
- 50% or more of your total gross receipts for 2008, 2009, and 2010 were from the trade or business of farming.
- The cancellation was made by a qualified person. A qualified person is an individual, organization, partnership, association, corporation, etc., who is actively and regularly engaged in the business of lending money. A qualified person also includes any federal, state, or local government or agency or instrumentality thereof. The United States Department of Agriculture is a qualified person. A qualified person cannot be related to you, cannot be the person from whom you acquired the property (or a person related to this person), and cannot be a person who receives a fee due to your investment in the property (or a person related to this person).

For the definition of the term "related person," see *Related persons* under *At-Risk Amounts* in Publication 925, *Passive Activity and At-Risk Rules*.

Note. This exclusion does not apply to a cancellation of debt in a title 11 bankruptcy case or to the extent you were insolvent immediately before the cancellation. If qualified farm debt is canceled in a title 11 case, you must apply the bankruptcy exclusion rather than the exclusion for canceled qualified farm debt. If you were insolvent immediately before the cancellation of qualified farm debt, you must apply the insolvency exclusion before applying the exclusion for canceled qualified farm debt.

Exclusion limit. The amount of canceled qualified farm debt you can exclude from income

under this exclusion is limited. It cannot be more than the sum of:

- Your adjusted tax attributes, and
- The total adjusted bases of qualified property you held at the beginning of 2012.

If you excluded canceled debt under the insolvency exclusion, the adjusted basis of any qualified property and adjusted tax attributes are determined after any reduction of tax attributes required under the insolvency exclusion.

Any canceled qualified farm debt that is more than this limit must be included in your income.

For more information about the basis of property, see Publication 551.

Adjusted tax attributes. Adjusted tax attributes means the sum of the following items.

1. Any net operating loss (NOL) for 2011 and any NOL carryover to 2011.
2. Any net capital loss for 2011 and any capital loss carryover to 2011.
3. Any passive activity loss carryover from 2011.
4. Three times the sum of any:
 - a. General business credit carryover to or from 2011,
 - b. Minimum tax credit available as of the beginning of 2012,
 - c. Foreign tax credit carryover to or from 2011, and
 - d. Passive activity credit carryover from 2011.

Qualified property. This is any property you use or hold for use in your trade or business or for the production of income.

How to report the qualified farm indebtedness exclusion. To show that all or part of your 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 your Form 1040. On line 2 of Form 982, include the amount of the qualified farm debt canceled, but not more than the exclusion limit (explained earlier). You must also reduce your tax attributes in Part II of Form 982 as explained under [Reduction of Tax Attributes](#), later.

Example 1. In 2011, Chuck was released from his obligation to pay a \$10,000 debt that was incurred directly in connection with his trade or business of farming. Chuck received a Form 1099-C from the qualified lender showing canceled debt of \$10,000 in box 2. For his 2008, 2009, and 2010 tax years, at least 50% of Chuck's total gross receipts were from the trade or business of farming. Chuck's adjusted tax attributes are \$5,000 and Chuck has \$3,000 total adjusted bases in qualified property at the beginning of 2012. Chuck had no other debt canceled during 2011, and no other exception or exclusion relating to canceled debt income applies.

Chuck can exclude \$8,000 (\$5,000 of adjusted tax attributes plus \$3,000 total adjusted bases in qualified property at the beginning of 2012) of the \$10,000 canceled debt from income. Chuck checks the box on line 1c of Form 982 and enters \$8,000 on line 2. Also, Chuck

Insolvency Worksheet

Keep for Your Records



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

completes Part II to reduce his tax attributes as explained under [Reduction of Tax Attributes](#), later. The remaining \$2,000 of canceled qualified farm debt is included in Chuck's income on Schedule F, line 8b.

Example 2. On March 1, 2011, Bob was released from his obligation to pay a \$10,000 business credit card debt that was used directly in connection with his farming business. For his 2008, 2009, and 2010 tax years, at least 50% of Bob's total gross receipts were from the trade or business of farming. Bob received a 2011 Form 1099-C from the qualified lender showing canceled debt of \$10,000 in box 2. The FMV of Bob's total assets on March 1, 2011, (immediately before the cancellation of the credit card debt) was \$7,000 and Bob's total liabilities at that time were \$11,000. Bob's adjusted tax attributes (a 2011 NOL) are \$7,000 and Bob has \$4,000 total adjusted bases in qualified property at the beginning of 2012.

Bob qualifies to exclude \$4,000 of the canceled debt under the insolvency exclusion because he is insolvent to the extent of \$4,000 immediately before the cancellation (\$11,000 total liabilities minus \$7,000 FMV of total assets). Bob must reduce his tax attributes under the insolvency rules before applying the rules for qualified farm debt. Bob also qualifies to exclude the remaining \$6,000 of canceled qualified farm debt. The limit on Bob's exclusion from income of canceled qualified farm debt is \$7,000, the sum of his adjusted tax attributes of \$3,000 (the \$7,000 NOL minus the \$4,000 reduction of tax attributes required because of the \$4,000 exclusion of canceled debt under the insolvency exclusion) plus \$4,000 (Bob's total adjusted bases in qualified property at the beginning of 2012).

Bob checks the boxes on lines 1b and 1c of Form 982 and enters \$10,000 on line 2. Bob completes Part II to reduce his tax attributes as explained under [Reduction of Tax Attributes](#), later. Bob does not include any of his canceled debt in income.

Example 3. The facts are the same as in Example 2 except that immediately before the cancellation Bob was insolvent to the extent of the full \$10,000 canceled debt. Because the exclusion for qualified farm debt does not apply to the extent that you were insolvent immediately before the cancellation, Bob checks only the box on line 1b of Form 982 and enters \$10,000 on line 2. Bob completes Part II to reduce his tax attributes based on the insolvency exclusion as explained under [Reduction of Tax Attributes](#), later. Bob does not include any of the canceled debt in income.

Qualified Real Property Business Indebtedness

You can elect to exclude canceled qualified real property business indebtedness from income. Qualified real property business indebtedness is debt (other than qualified farm debt) that meets all of the following conditions.

1. It was incurred or assumed in connection with real property used in a trade or business.
2. It is secured by that real property.
3. It was incurred or assumed:
 - a. Before 1993, or

- b. After 1992, if the debt is either (i) qualified acquisition indebtedness (defined next), or (ii) debt incurred to refinance qualified real property business debt incurred or assumed before 1993 (but only to the extent the amount of such debt does not exceed the amount of debt being refinanced).

4. It is debt to which you elect to apply these rules.

Definition of qualified acquisition indebtedness.

Qualified acquisition indebtedness is:

- Debt incurred or assumed to acquire, construct, reconstruct, or substantially improve real property that is used in a trade or business and secures the debt, or
- Debt resulting from the refinancing of qualified acquisition indebtedness, to the extent the amount of the debt does not exceed the amount of debt being refinanced.

Note. This exclusion does not apply to a cancellation of debt in a title 11 bankruptcy case or to the extent you were insolvent immediately before the cancellation. If qualified real property business debt is canceled in a title 11 bankruptcy case, you must apply the bankruptcy exclusion rather than the exclusion for canceled qualified real property business debt. If you were insolvent immediately before the cancellation of qualified real property business debt, you must apply the insolvency exclusion before applying the exclusion for canceled qualified real property business debt.

Exclusion limit. The amount of canceled qualified real property business debt you can exclude from income is limited under this exclusion to 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, reduced by the outstanding principal amount of any other qualified real property business debt secured by that property (immediately before the cancellation).

In addition to this limit, a second overall limit applies. The amount of canceled qualified real property business debt you can exclude from income cannot be more than the total adjusted bases of depreciable real property you held immediately before the cancellation of the qualified real property business indebtedness (other than depreciable real property acquired in contemplation of the cancellation). When figuring this overall limit, use the adjusted basis of the depreciable real property after any reductions in basis required because of the exclusion of debt canceled under the bankruptcy, insolvency, or farm debt provisions described in this publication.

For more information about the basis of property, see Publication 551.

How to elect the qualified real property business debt exclusion. You must make an

election to exclude canceled qualified real property business debt from gross income. The election must be made on a timely filed (including extensions) federal income tax return for 2011 and can be revoked only with IRS consent. The election is made by completing Form 982 in accordance with its instructions. Attach Form 982 to your federal income tax return for 2011 and check the box on line 1d. Include the amount of canceled qualified real property business debt (but not more than the amount of the exclusion limit, explained earlier) on line 2 of Form 982. You must also reduce your tax attributes in Part II of Form 982 as explained under [Reduction of Tax Attributes](#), later.

If you timely filed your tax return without making this election, you can still make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). Enter "Filed pursuant to section 301.9100-2" on the amended return and file it at the same place you filed the original return.

Example. In 2006, Curt bought a retail store for use in a business he operated as a sole proprietorship. Curt made a \$20,000 down payment and financed the remaining \$200,000 of the purchase price with a bank loan. The bank loan was a recourse loan and was secured by the property. Curt used the property in his business continuously since he bought it. Curt had no other debt secured by that depreciable real property. In addition to the retail store, Curt owned depreciable equipment and furniture with an adjusted basis of \$50,000.

Curt's business encountered financial difficulties in 2011. On September 26, 2011, the bank financing the retail store loan entered into a workout agreement with Curt under which it canceled \$20,000 of the debt. Immediately before the cancellation, the outstanding principal balance on the retail store loan was \$185,000, the FMV of the store was \$165,000, and the adjusted basis was \$210,000 (\$220,000 cost minus \$10,000 accumulated depreciation).

The bank sent Curt a 2011 Form 1099-C showing canceled debt of \$20,000 in box 2. Curt had no tax attributes other than basis to reduce and did not qualify for any exception or exclusion other than the qualified real property business debt exclusion.

Curt elects to apply the qualified real property business debt exclusion to the canceled debt. The amount of canceled qualified real property business debt that Curt can exclude from income is limited to \$20,000 (the excess of the \$185,000 outstanding principal amount of his qualified real property business debt immediately before the cancellation over the \$165,000 FMV of the business real property securing the debt). Curt's exclusion is also subject to a \$210,000 limit equal to the adjusted basis of depreciable real property he held immediately before the cancellation.

Thus, Curt can exclude the entire \$20,000 of canceled qualified real property business debt from income. Curt checks the box on line 1d of Form 982 and enters \$20,000 on line 2. Curt must also use line 4 of Form 982 to reduce his basis in depreciable real property by the \$20,000 of canceled qualified real property business debt excluded from his income as explained under [Reduction of Tax Attributes](#), later.

Qualified Principal Residence Indebtedness

You can exclude canceled debt from income if it is qualified principal residence indebtedness. Qualified principal residence indebtedness is any mortgage you took out to buy, build, or substantially improve your main home. It also must be secured by your main home. Qualified principal residence indebtedness also includes any debt secured by your main home that you used to refinance a mortgage you took out to buy, build, or substantially improve your main home, but only up to the amount of the old mortgage principal just before the refinancing.

Example 1. In 2005, Becky bought a main home for \$315,000. Becky took out a \$300,000 mortgage loan to buy the home and made a down payment of \$15,000. The loan was secured by the home. In 2006, Becky took out a second mortgage loan in the amount of \$50,000 that she used to add a garage to her home.

In 2011, when the outstanding principal of her first and second mortgage loans was \$325,000, Becky refinanced the two loans into one loan in the amount of \$400,000. The FMV of the home at the time of the refinancing was \$430,000. Becky used the additional \$75,000 debt proceeds (\$400,000 new mortgage loan minus \$325,000 outstanding principal balances of Becky's first and second mortgage loans immediately before the refinancing) to pay off personal credit cards and to pay college tuition for her daughter.

After the refinancing, Becky's qualified principal residence indebtedness is \$325,000 because the debt resulting from the refinancing is qualified principal residence indebtedness only to the extent it is not more than the old mortgage principal just before the refinancing.

Example 2. In 2004, Steve acquired his main home for \$200,000, subject to a mortgage of \$175,000. In 2005, he took out a home equity loan for \$10,000, secured by his main home, which he used to pay off personal credit cards.

In 2006, when the outstanding principal on his mortgage was \$170,000 and the outstanding principal on his home equity loan was \$9,000, he refinanced the two loans into one loan in the amount of \$200,000. The FMV of the home at the time of refinancing was \$210,000. He used the additional \$21,000 (\$200,000 new mortgage loan minus \$179,000 outstanding principal balances on the mortgage and home equity loan) to cover medical expenses.

After refinancing, Steve's qualified principal residence indebtedness is \$170,000 because the debt resulting from the refinancing is qualified principal residence indebtedness only to the extent it refinances debt that had been secured by the main home and was used to buy, build, or substantially improve the main home.

Main home. Your main home is the home where you ordinarily live most of the time. You can have only one main home at any one time.

Note. This exclusion does not apply to a cancellation of debt in a title 11 bankruptcy case. If qualified principal residence indebtedness is canceled in a title 11 bankruptcy case, you must apply the bankruptcy exclusion rather than the exclusion for qualified principal residence indebtedness. If you were insolvent immediately before the cancellation, you can elect to apply

the insolvency exclusion (as explained under [Insolvency](#), earlier) instead of applying the qualified principal residence indebtedness exclusion. To do this, check the box on line 1b of Form 982 instead of the box on line 1e.

Exclusion limit. The maximum amount you can treat as qualified principal residence indebtedness is \$2 million (\$1 million if married filing separately). You cannot exclude canceled qualified principal residence indebtedness from income if the cancellation was for services performed for the lender or on account of any other factor not directly related to a decline in the value of your home or to your financial condition.

Ordering rule. If only a part of a loan is qualified principal residence indebtedness, the exclusion applies only to the extent the amount canceled is more than the amount of the loan (immediately before the cancellation) that is **not** qualified principal residence indebtedness. The remaining part of the loan may qualify for another exclusion.

Example. Ken incurred recourse debt of \$800,000 when he bought his main home for \$880,000. When the FMV of the property was \$1,000,000, Ken refinanced the debt for \$850,000. At the time of the refinancing, the principal balance of the original mortgage loan was \$740,000. Ken used the \$110,000 he obtained from the refinancing (\$850,000 minus \$740,000) to pay off his credit cards and to buy a new car.

About 2 years after the refinancing, Ken lost his job and was unable to get another job paying a comparable salary. Ken's home had declined in value to between \$700,000 and \$750,000. Based on Ken's circumstances, the lender agreed to allow a short sale of the property for \$735,000 and to cancel the remaining \$115,000 of the \$850,000 debt. Under the ordering rule, Ken can exclude only \$5,000 of the canceled debt from his income under the exclusion for canceled qualified principal residence indebtedness (\$115,000 canceled debt minus the \$110,000 amount of the debt that was not qualified principal residence indebtedness). Ken must include the remaining \$110,000 of canceled debt in income on line 21 of his Form 1040 (unless another exclusion applies).

How to report the qualified principal residence indebtedness 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 your federal income 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 (explained earlier). If you continue to own your home after a cancellation of qualified principal residence indebtedness, you must reduce your basis in the home as explained under [Reduction of Tax Attributes](#), next.

Reduction of 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. The order in which the tax attributes are reduced depends on the reason the canceled debt was excluded from income. If the total amount of canceled debt excluded from income (line 2 of Form 982) was more than your total tax attributes, the total reduction of tax attributes in Part II of Form 982 will be less than the amount on line 2.

Qualified Principal Residence Indebtedness

If you exclude canceled qualified principal residence indebtedness from income and you continue to own the home after the cancellation, you must reduce the basis of the home (but not below zero) by the amount of the canceled qualified principal residence indebtedness excluded from income. Enter the amount of the basis reduction on line 10b of Form 982.

For more details on determining the basis of your main home, see Publication 523.

Bankruptcy and Insolvency

No tax attributes other than basis of personal-use property. If the canceled debt you are excluding is a debt other than qualified principal residence indebtedness (such as a car loan or credit card debt) and you have no tax attributes other than the adjusted basis of personal-use property you own (see the list of seven tax attributes, later), you must reduce the basis of the personal-use property you held at the beginning of 2012 (in proportion to adjusted basis). Personal-use property is any property that is not used in your trade or business nor held for investment (such as your home, home furnishings, and car). Include on line 10a of Form 982 the smallest of:

- The bases of your personal-use property held at the beginning of 2012,
- The amount of canceled nonbusiness debt (other than qualified principal residence indebtedness) that you are excluding from income on line 2 of Form 982, or
- The excess of the total bases of the property and the amount of money you held immediately after the cancellation over your total liabilities immediately after the cancellation.

For general information about the basis of property, see Publication 551.

Example. In 2008, Kyra bought a car for personal use. The cost of the car was \$12,000. Kyra put down \$2,000 and took out a loan of \$10,000 to buy the car. The loan was a recourse loan, meaning that Kyra was personally liable for the full amount of the debt.

On December 7, 2011, when the balance of the loan was \$8,500, the lender repossessed and sold the car because Kyra had stopped making payments on the loan. The FMV of the car was \$7,000 at the time the lender repossessed and sold it. The lender applied the \$7,000 it received on sale of the car against Kyra'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).

Kyra's only other assets at the time of the cancellation are the furniture in her apartment which has a cost basis of \$5,000 and an FMV of \$3,000, jewelry with a basis of \$500 and an FMV of \$1,000, and a \$600 balance in her savings account. Thus, the FMV of Kyra's total assets immediately before the cancellation was \$11,600 (\$7,000 car plus \$3,000 furniture plus \$1,000 jewelry plus \$600 savings). Kyra 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 balance on car loan plus \$6,000 student loan balance). Other than the car, which was repossessed, Kyra held all of these assets at the beginning of 2012. The FMV and bases of the assets remained the same at the beginning of 2012.

Kyra received a 2011 Form 1099-C showing \$1,500 in box 2 (amount of debt canceled) and \$7,000 in box 7 (FMV of the property). Kyra 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 (\$14,500 of total liabilities immediately before the cancellation minus \$11,600 FMV of total assets at that time).

Kyra checks box 1b on Form 982 and enters \$1,500 on line 2. Kyra enters \$100 on line 10a (the smallest of: (a) the \$5,500 bases of Kyra's personal-use property held at the beginning of 2012 (\$5,000 furniture plus \$500 jewelry), (b) the \$1,500 nonbusiness debt she is excluding from income on line 2 of Form 982, or (c) the \$100 excess of the total bases of the property and the amount of money Kyra held immediately after the cancellation over Kyra's total liabilities at that time (\$5,500 bases of property held immediately after the cancellation plus \$600 savings minus \$6,000 student loan).

Kyra must reduce her bases in each item of property in proportion to her total adjusted bases in all her property. Thus, Kyra reduces her basis in the furniture by \$91 (\$100 x 5,000/5,500) and her basis in the jewelry by \$9 (\$100 x 500/5,500).

All other tax attributes. If the canceled debt is excluded by reason of the bankruptcy or insolvency exclusions, you must use the excluded debt to reduce the following tax attributes (but not below zero) in the order listed unless you elect to reduce the basis of depreciable property first, as explained later. The reduction of tax attributes must be made after figuring your income tax liability for 2011.

1. **Net operating loss (NOL).** First reduce any 2011 NOL and then reduce any NOL carryover to 2011 (after taking into account any amount used to reduce 2011 taxable income) in the order of the tax years from which the carryovers arose, starting with the earliest year. Reduce the NOL or carryover by one dollar for each dollar of excluded canceled debt.
2. **General business credit carryover.** Reduce the credit carryover to or from 2011. Reduce the credit carryovers to 2011 in the order in which they are taken into account for 2011. For more information on

the credit ordering rules for 2011, see the Instructions for Form 3800, General Business Credit. Reduce the carryover by 33 $\frac{1}{3}$ cents for each dollar of excluded canceled debt.

3. **Minimum tax credit.** Reduce the minimum tax credit available at the beginning of 2012. Reduce the credit by 33 $\frac{1}{3}$ cents for each dollar of excluded canceled debt.
4. **Capital loss.** First reduce any 2011 net capital loss and then any capital loss carryover to 2011. Reduce the capital loss or carryover by one dollar for each dollar of excluded canceled debt.
5. **Basis.** Reduce the bases of the property you hold at the beginning of 2012 in the following order (and, within each category, in proportion to adjusted basis).
 - a. Real property (other than real property held for sale in the ordinary course of business) used in your trade or business or held for investment that secured the canceled debt.
 - b. Personal property (except inventory and accounts and notes receivable) used in your trade or business or held for investment that secured the canceled debt.
 - c. Other property (except inventory, accounts receivable, notes receivable, and real property held primarily for sale to customers) used in your trade or business or held for investment.
 - d. Inventory, accounts receivable, notes receivable, and real property held primarily for sale to customers.
 - e. Personal-use property (property not used in your trade or business nor held for investment).

Reduce the basis by one dollar for each dollar of excluded canceled debt. However, the reduction cannot be more than the excess of the total bases of the property and the amount of money you held immediately after the debt cancellation over your total liabilities immediately after the cancellation.

For allocation rules that apply to basis reductions for multiple canceled debts, see Regulations section 1.1017-1(b)(2). Also see [Election to reduce the basis of depreciable property before reducing other tax attributes](#), later.

6. **Passive activity loss and credit carryovers.** Reduce the passive activity loss and credit carryovers from 2011. Reduce the loss carryover by one dollar for each dollar of excluded canceled debt. Reduce the credit carryover by 33 $\frac{1}{3}$ cents for each dollar of excluded canceled debt.
7. **Foreign tax credit.** Reduce the credit carryover to or from 2011. Reduce the credit carryovers to 2011 in the order in which they are taken into account for 2011. Reduce the carryover by 33 $\frac{1}{3}$ cents for each dollar of excluded canceled debt.

Election to reduce the basis of depreciable property before reducing other tax attributes. You can elect to reduce the bases of depreciable property you held at the beginning of 2012 before reducing other tax attributes. You can reduce the basis of this property by all or part of the canceled debt. Basis of property is reduced in the following order.

1. Depreciable real property used in your trade or business or held for investment that secured the canceled debt.
2. Depreciable personal property used in your trade or business or held for investment that secured the canceled debt.
3. Other depreciable property used in your trade or business or held for investment.
4. Real property held primarily for sale to customers if you elect to treat it as if it were depreciable property on Form 982.

Basis reduction is limited to the total adjusted bases of all your depreciable property. Depreciable property for this purpose means any property subject to depreciation or amortization, but only if a reduction of basis will reduce the depreciation or amortization otherwise allowable for the period immediately following the basis reduction. If the amount of canceled debt excluded from income is more than the total bases in depreciable property, you must use the excess to reduce the other tax attributes in the order described earlier under *All other tax attributes*. In figuring the limit on the basis reduction in (5), *Basis*, use the remaining adjusted bases of your properties after making this election. See Form 982 for information on how to make this election. The election can be revoked only with IRS consent.

Recapture of basis reductions. If you reduce the basis of property under these provisions and later sell or otherwise dispose of the property at a gain, the part of the gain due to this basis reduction is taxable as ordinary income under the depreciation recapture provisions. Treat any property that is not section 1245 or section 1250 property as section 1245 property. For section 1250 property, determine the depreciation adjustments that would have resulted under the straight line method as if there were no basis reduction for debt cancellation. See Publication 544 or Publication 225 for more details on sections 1245 and 1250 property and the recapture of gain as ordinary income.

Qualified Farm Indebtedness

If you exclude canceled debt from income under both the insolvency exclusion and the exclusion for qualified farm indebtedness, you must first reduce your tax attributes by the amount excluded under the insolvency exclusion. Then reduce your remaining tax attributes (but not below zero) by the amount of canceled debt that qualifies for the farm debt exclusion.

Generally, when reducing your tax attributes for canceled qualified farm indebtedness excluded from income, reduce them in the same order explained under [Bankruptcy and Insolvency](#), earlier. However, do not follow the rules in item (5), *Basis*. Instead, reduce only the basis of qualified property. Qualified property is any property you use or hold for use in your trade or business or for the production of income. Reduce the basis of qualified property in the following order.

1. Depreciable qualified property. You can elect on Form 982 to treat real property held primarily for sale to customers as if it were depreciable property.
2. Land that is qualified property and is used or held for use in your farming business.
3. Other qualified property.

Qualified Real Property Business Indebtedness

If you make an election to exclude canceled qualified real property business debt from income, you must reduce the basis of your depreciable real property (but not below zero) by the amount of canceled qualified real property business debt excluded from income. The basis reduction is made at the beginning of 2012. However, if you dispose of your depreciable real property before the beginning of 2012, you must reduce its basis (but not below zero) immediately before the disposition. Enter the amount of the basis reduction on line 4 of Form 982.

Example 1. In 2006 Curt bought a retail store for use in a business he operated as a sole proprietorship. Curt made a \$20,000 down payment and financed the remaining \$200,000 of the purchase price with a bank loan. The bank loan was a recourse loan and was secured by the property. Curt used the property in his business continuously since he bought it. Curt had no other debt secured by that depreciable real property. In addition to the retail store, Curt owned depreciable equipment and furniture with an adjusted basis of \$50,000. Curt's tax attributes included the basis of depreciable property, a net operating loss, and a capital loss carryover to 2011.

Curt's business encountered financial difficulties in 2011. On September 26, 2011, the bank financing the retail store loan entered into a workout agreement with Curt under which it canceled \$20,000 of the principal amount of the debt. Immediately before the bank entered into the workout agreement, Curt was insolvent to the extent of \$12,000. At that time, the outstanding principal balance on the retail store loan was \$185,000, the FMV of the store was \$165,000, and the adjusted basis was \$210,000 (\$220,000 cost minus \$10,000 accumulated depreciation). The bank sent Curt a 2011 Form 1099-C showing canceled debt of \$20,000 in box 2.

Curt must apply the insolvency exclusion before applying the exclusion for canceled qualified real property business indebtedness. Under the insolvency exclusion rules, Curt can exclude \$12,000 of the canceled debt from income. Curt elects to reduce his basis of depreciable property before reducing other tax attributes. Under that election, Curt must first reduce his basis in the depreciable real property used in his trade or business that secured the canceled debt. After

the basis reduction, Curt's adjusted basis in that property is \$198,000 (\$210,000 adjusted basis before entering into the workout agreement minus \$12,000 of canceled debt excluded from income under the insolvency exclusion).

The exclusion for qualified real property business indebtedness is limited to \$20,000, the excess of the outstanding principal amount of the qualified real property business indebtedness (immediately before the cancellation) over the FMV (immediately before the cancellation) of the real property securing the debt (\$185,000 minus \$165,000). Curt's exclusion is also limited to \$198,000, the total adjusted basis (determined after reduction for the canceled debt excluded under the insolvency exclusion) of his depreciable real property he held immediately before the cancellation. Since both of these limits exceed the \$8,000 of remaining canceled debt (\$20,000 minus \$12,000), Curt can exclude \$8,000 under the qualified real property business indebtedness exclusion.

Curt checks the boxes on lines 1b and 1d of Form 982. He completes Part II of Form 982 to reduce his basis in the depreciable real property by \$20,000, the amount of the canceled debt excluded from income. Curt enters \$8,000 on line 4 and \$12,000 on line 5.

Example 2. Bob owns depreciable real property used in his retail business. His adjusted basis in the property is \$145,000. The FMV of the property is \$120,000. The property is subject to \$134,000 of recourse debt which is secured by the property. Bob had no other debt secured by that depreciable real property. Bob also had a \$15,000 NOL in 2011.

During 2011, Bob entered into a workout agreement with the lender under which the lender canceled \$14,000 of the debt on the real property used in Bob's business. Immediately before the cancellation, Bob was insolvent to the extent of \$10,000. Bob excludes \$10,000 of the canceled debt from income under the insolvency exclusion. As a result of that exclusion, Bob reduced his NOL by \$10,000.

Bob may be able to exclude the remaining \$4,000 of canceled debt from income under the qualified real property business indebtedness provision, if he elects to apply it. The amount he can exclude is subject to both of the following limits.

- 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 (the excess of \$134,000 over \$120,000, which equals \$14,000).
- The total adjusted bases of depreciable property held immediately before the cancellation of debt (\$145,000).

Since both limits (\$14,000 and \$145,000) are more than the remaining \$4,000 of canceled debt, Bob can also exclude that \$4,000 of canceled debt.

Bob checks the boxes on lines 1b and 1d of Form 982 and enters \$14,000 on line 2. Bob completes Part II of Form 982 to reduce his basis of depreciable real property and his 2011 NOL by entering \$4,000 on line 4 and \$10,000 on line 6. None of the canceled debt is included in Bob's income.

2.

Foreclosures and Repossessions

If you do not make payments you owe on a loan secured by property, the lender may foreclose on the loan or repossess the property. The foreclosure or repossession is treated as a sale from which you may realize gain or loss. This is true even if you voluntarily return the property to the lender. If the outstanding loan balance was more than the FMV of the property and the lender cancels all or part of the remaining loan balance, you also may realize ordinary income from the cancellation of debt. You must report this income on your return unless certain exceptions or exclusions apply. See [chapter 1](#) for more details.

Borrower's gain or loss. You figure and report gain or loss from a foreclosure or repossession in the same way as gain or loss from a sale. The gain is the difference between the amount realized and your adjusted basis in the transferred property (amount realized minus adjusted basis). The loss is the difference between your adjusted basis in the transferred property and the amount realized (adjusted basis minus amount realized). For more information on figuring gain or loss from the sale of property, see *Gain or Loss From Sales and Exchanges* in Publication 544.



You can use Table 1-1 to figure your ordinary income from the cancellation of debt and your gain or loss from a foreclosure or repossession.

Amount realized and ordinary income on a recourse debt. If you are personally liable for the debt, the amount realized on the foreclosure or repossession includes the smaller of:

- The outstanding debt immediately before the transfer reduced by any amount for which you remain personally liable immediately after the transfer, or
- The FMV of the transferred property.

The amount realized also includes any proceeds you received from the foreclosure sale. If the FMV of the transferred property is less than the total outstanding debt immediately before the transfer reduced by any amount for which you remain personally liable immediately after the transfer, the difference is ordinary income from the cancellation of debt. You must report this income on your return unless certain exceptions or exclusions apply. See [chapter 1](#) for more details.

Example 1. Tara bought a new car for \$15,000. She paid \$2,000 down and borrowed the remaining \$13,000 from the dealer's credit company. Tara is personally liable for the loan (recourse debt) and the car is pledged as security for the loan. On August 1, 2011, the credit company repossessed the car because Tara

Table 1-1. Worksheet for Foreclosures and Repossessions

Keep for Your Records



Part 1. Complete Part 1 only if you were personally liable for the debt (even if none of the debt was canceled). Otherwise, go to Part 2.	
1. Enter the amount of outstanding debt immediately before the transfer of property reduced by any amount for which you remain personally liable immediately after the transfer of property	_____
2. Enter the fair market value of the transferred property	_____
3. Ordinary income from the cancellation of debt upon foreclosure or repossession.* Subtract line 2 from line 1. If less than zero, enter zero. Next, go to Part 2	=====
Part 2. Gain or loss from foreclosure or repossession.	
4. Enter the smaller of line 1 or line 2. If you did not complete Part 1 (because you were not personally liable for the debt), enter the amount of outstanding debt immediately before the transfer of property	_____
5. Enter any proceeds you received from the foreclosure sale	_____
6. Add line 4 and line 5	_____
7. Enter the adjusted basis of the transferred property	_____
8. Gain or loss from foreclosure or repossession. Subtract line 7 from line 6	=====
* The income may not be taxable. See chapter 1 for more details.	

had stopped making loan payments. The balance due after taking into account the payments Tara made was \$10,000. The FMV of the car when it was repossessed was \$9,000. On November 15, 2011, the credit company forgave the remaining \$1,000 balance on the loan due to insufficient assets.

In this case, the amount Tara realizes is \$9,000. This is the smaller of:

- The \$10,000 outstanding debt immediately before the repossession reduced by the \$1,000 for which she remains personally liable immediately after the repossession (\$10,000 – \$1,000 = \$9,000), or
- The \$9,000 FMV of the car.

Tara figures her gain or loss on the repossession by comparing the \$9,000 amount realized with her \$15,000 adjusted basis. She has a \$6,000 nondeductible loss. After the cancellation of the remaining balance on the loan in November, Tara also has ordinary income from cancellation of debt in the amount of \$1,000 (the remaining balance on the \$10,000 loan after the \$9,000 amount satisfied by the FMV of the repossessed car). Tara must report this \$1,000 on her return unless one of the exceptions or exclusions described in [chapter 1](#) applies.

Example 2. Lili paid \$200,000 for her home. She paid \$15,000 down and borrowed the remaining \$185,000 from a bank. Lili is personally liable for the loan and the house is pledged as security for the loan. In 2011, the bank foreclosed on the loan because Lili stopped making payments. When the bank foreclosed the mortgage, the balance due was \$180,000, the FMV of the house was \$170,000, and Lili’s adjusted basis was \$175,000 due to a casualty loss she had deducted. At the time of the foreclosure, the bank forgave \$2,000 of the \$10,000 debt in excess of the FMV (\$180,000 minus \$170,000). Lili remained personally liable for the \$8,000 balance.

In this case, Lili has ordinary income from the cancellation of debt in the amount of \$2,000. The \$2,000 income from the cancellation of debt is figured by subtracting the \$170,000 FMV of

the house from the \$172,000 difference between Lili’s total outstanding debt immediately before the transfer of property reduced by the amount for which she remains personally liable immediately after the transfer (\$180,000 minus \$8,000). Lili is able to exclude the \$2,000 of canceled debt from her income under the qualified principal residence indebtedness rules discussed earlier.

Lili must also determine her gain or loss from the foreclosure. In this case, the amount that Lili realizes is \$170,000. This is the smaller of: (a) the \$180,000 outstanding debt immediately before the transfer reduced by the \$8,000 for which she remains personally liable immediately after the transfer (\$180,000 – \$8,000 = \$172,000) or (b) the \$170,000 FMV of the house. Lili figures her gain or loss on the foreclosure by comparing the \$170,000 amount realized with her \$175,000 adjusted basis. She has a \$5,000 nondeductible loss.

Amount realized on a nonrecourse debt. If you are not personally liable for repaying the debt secured by the transferred property, the amount you realize includes the full amount of the outstanding debt immediately before the transfer. This is true even if the FMV of the property is less than the outstanding debt immediately before the transfer.

Example 1. Tara bought a new car for \$15,000. She paid \$2,000 down and borrowed the remaining \$13,000 from the dealer’s credit company. Tara is not personally liable for the loan (nonrecourse), but pledged the new car as security for the loan.

On August 1, 2011, the credit company repossessed the car because Tara had stopped making loan payments. The balance due after taking into account the payments Tara made was \$10,000. The FMV of the car when it was repossessed was \$9,000.

The amount Tara realized on the repossession is \$10,000. That is the outstanding amount of debt immediately before the repossession, even though the FMV of the car is less than \$10,000. Tara figures her gain or loss on the

repossession by comparing the \$10,000 amount realized with her \$15,000 adjusted basis. Tara has a \$5,000 nondeductible loss.

Example 2. Lili paid \$200,000 for her home. She paid \$15,000 down and borrowed the remaining \$185,000 from a bank. Lili is not personally liable for the loan, but pledges the house as security.

The bank foreclosed on the mortgage because Lili stopped making payments. When the bank foreclosed on the loan, the balance due was \$180,000, the FMV of the house was \$170,000, and Lili’s adjusted basis was \$175,000 due to a casualty loss she had deducted.

The amount Lili realized on the foreclosure is \$180,000, the outstanding debt immediately before the foreclosure. She figures her gain or loss by comparing the \$180,000 amount realized with her \$175,000 adjusted basis. Lili has a \$5,000 realized gain. See Publication 523 to figure and report any taxable amount.

Forms 1099-A and 1099-C. A lender who acquires an interest in your property in a foreclosure or repossession should send you Form 1099-A, Acquisition or Abandonment of Secured Property, showing information you need to figure your gain or loss. However, if the lender also cancels part of your debt and must file Form 1099-C, the lender can include the information about the foreclosure or repossession on that form instead of on Form 1099-A. The lender must file Form 1099-C and send you a copy if the amount of debt canceled is \$600 or more and the lender is a financial institution, credit union, federal government agency, or any organization that has a significant trade or business of lending money. For foreclosures or repossessions occurring in 2011, these forms should have been sent to you by January 31, 2012.

3.

Abandonments

You abandon property when you voluntarily and permanently give up possession and use of the property with the intention of ending your ownership but without passing it on to anyone else. Whether an abandonment has occurred is determined in light of all the facts and circumstances. You must both show an intention to abandon the property and affirmatively act to abandon the property.

A voluntary conveyance of the property in lieu of foreclosure is not an abandonment and is treated as the exchange of property to satisfy a debt; for more information see *Sales and Exchanges* in Publication 544.

The tax consequences of abandonment of property that secures a debt depend on whether you were personally liable for the debt (recourse debt) or were not personally liable for the debt (nonrecourse debt).



See Publication 544 instead if you abandoned property that did not secure debt. This publication only discusses the tax consequences of abandoning property securing a debt.

Abandonment of property securing recourse debt. Generally, if you abandon property that secures debt for which you are personally liable (recourse debt), you do not have gain or loss until the later foreclosure is completed. For details on figuring gain or loss on the foreclosure, see [chapter 2](#).

Example 1—abandonment of personal-use property securing recourse debt. In 2007, Anne purchased a home for \$200,000. She borrowed the entire purchase price, for which she was personally liable, and gave the bank a mortgage on the home. In 2011, Anne lost her job and was unable to continue making her mortgage loan payments. Because her mortgage loan balance was \$185,000 and the FMV of her home was only \$150,000, Anne decided to abandon her home by permanently moving out on August 1, 2011. Because Anne was personally liable for the debt, Anne has neither gain nor loss in tax year 2011 from abandoning the home. The bank sells the house at a foreclosure sale in 2012. Anne will have to figure her gain or nondeductible loss for tax year 2012 as discussed earlier in [chapter 2](#).

Example 2—abandonment of business or investment property securing recourse debt. In 2007, Sue purchased business property for \$200,000. She borrowed the entire purchase price, for which she was personally liable, and gave the lender a security interest in the property. In 2011, Sue was unable to continue making her loan payments. Because her loan balance was \$185,000 and the FMV of the property was only \$150,000, Sue abandoned the property on August 1, 2011. Because Sue was personally liable for the debt, Sue has neither gain nor loss in tax year 2011 from abandoning the property. The lender sells the property at a foreclosure sale in 2012. Sue will have to figure her gain or deductible loss for tax year 2012 as discussed earlier in [chapter 2](#).

Abandonment of property securing nonrecourse debt. If you abandon property that secures debt for which you are not personally liable (nonrecourse debt), the abandonment is treated as a sale or exchange.

The amount you realize on the abandonment of property that secured nonrecourse debt is the amount of the nonrecourse debt. If the amount you realize is more than your adjusted basis, then you have a gain. If your adjusted basis is more than the amount you realize, then you have a loss. For more information on how to figure gain and loss, see *Gain or Loss from Sales or Exchanges* in Publication 544.

Loss from abandonment of business or investment property is deductible as a loss. The character of the loss depends on the character of the property. The amount of deductible capital loss may be limited. For more information, see *Treatment of Capital Losses* in Publication 544. You cannot deduct any loss from abandonment of your home or other property held for personal use.

Example 1—abandonment of personal-use property securing nonrecourse debt. In 2007, Timothy purchased a home for

\$200,000. He borrowed the entire purchase price, for which he was not personally liable, and gave the bank a mortgage on the home. In 2011, Timothy lost his job and was unable to continue making his mortgage loan payments. Because his mortgage loan balance was \$185,000 and the FMV of his home was only \$150,000, Timothy decided to abandon his home by permanently moving out on August 1, 2011. Because Timothy was not personally liable for the debt, the abandonment is treated as a sale or exchange of the home in tax year 2011. Timothy's amount realized is \$185,000 and his adjusted basis in the home is \$200,000. Timothy has a \$15,000 nondeductible loss in tax year 2011. (Had Timothy's adjusted basis been less than the amount realized, Timothy would have had a gain that he would have to include in gross income.) The bank sells the house at a foreclosure sale in 2012. Timothy has neither gain nor loss from the foreclosure sale. Because he was not personally liable for the debt, he also has no cancellation of debt income.

Example 2—abandonment of business or investment property securing nonrecourse debt. In 2007, Robert purchased business property for \$200,000. He borrowed the entire purchase price, for which he was not personally liable, and gave the lender a security interest in the property. In 2011, Robert was unable to continue making his loan payments. Because his loan balance was \$185,000 and the FMV of the property was only \$150,000, Robert decided to abandon the property on August 1, 2011. Because Robert was not personally liable for the debt, the abandonment is treated as a sale or exchange of the property in tax year 2011. Robert's amount realized is \$185,000 and his adjusted basis in the property is \$180,000 (as a result of \$20,000 of depreciation deductions on the property). Robert has a \$5,000 gain in tax year 2011. (Had Robert's adjusted basis been greater than the amount realized, he would have had a deductible loss.) The lender sells the property at a foreclosure sale in 2012. Robert has neither gain nor loss from the foreclosure sale. Because he was not personally liable for the debt, he also has no cancellation of debt income.

Canceled debt. If the abandoned property secures a debt for which you are personally liable and the debt is canceled, you will realize ordinary income equal to the canceled debt. This income is separate from any amount realized from abandonment of the property. You must report this income on your return unless one of the exceptions or exclusions described in chapter 1 applies. See [chapter 1](#) for more details.

Forms 1099-A and 1099-C. Generally, if you abandon

- real property (such as a home),
- intangible property, or
- tangible personal property held (wholly or partly) for use in a trade or business or for investment,

that secures a loan and the lender knows the property has been abandoned, the lender should send you Form 1099-A showing information you need to figure your gain or loss from the abandonment. Also, if your debt is canceled and the lender must file Form 1099-C, the lender can

include the information about the abandonment on that form instead of on Form 1099-A. The lender must file Form 1099-C and send you a copy if the amount of debt canceled is \$600 or more and the lender is a financial institution, credit union, federal government agency, or any organization that has a significant trade or business of lending money. For abandonments of property and debt cancellations occurring in 2011, these forms should have been sent to you by January 31, 2012.

4. Detailed Examples

These examples use actual forms to help you prepare your income tax return. However, the information shown on the filled-in forms is not from any actual person or scenario.

Example 1—Mortgage loan modification. In 2005, Nancy Oak bought a main home for \$435,000. Nancy took out a \$420,000 mortgage loan to buy the home and made a down payment of \$15,000. The loan was secured by the home. The mortgage loan was a recourse debt, meaning that Nancy was personally liable for the debt. In 2006, Nancy took out a second mortgage loan (also a recourse debt) in the amount of \$30,000 that was used to substantially improve her kitchen.

In 2009, when the outstanding principal of the first and second mortgage loans was \$440,000, Nancy refinanced the two recourse loans into one recourse loan in the amount of \$475,000. The FMV of Nancy's home at the time of the refinancing was \$500,000. Nancy used the additional \$35,000 debt (\$475,000 new mortgage loan minus \$440,000 outstanding principal of Nancy's first and second mortgage loans immediately before the refinancing) to pay off personal credit cards and to pay college tuition for her son. After the refinancing, Nancy has qualified principal residence indebtedness in the amount of \$440,000 because the refinanced debt is qualified principal residence indebtedness only to the extent the amount of debt is not more than the old mortgage principal just before the refinancing.

In 2011, Nancy was unable to make her mortgage loan payments. On August 31, 2011, when the outstanding balance of her refinanced mortgage loan was still \$475,000 and the FMV of the property was \$425,000, Nancy's bank agreed to a loan modification (a "workout") that resulted in a \$40,000 reduction in the principal balance of her loan. Nancy was neither insolvent nor in bankruptcy at the time of the loan modification.

Nancy received a 2011 Form 1099-C from her bank in January 2012 showing canceled debt of \$40,000 in box 2. To determine if she must include the canceled debt in her income, Nancy must determine whether she meets any of the exceptions or exclusions that apply to canceled debts. Nancy determines that the only

exception or exclusion that applies to her is the qualified principal residence indebtedness exclusion.

Next, Nancy determines the amount, if any, of the \$40,000 of canceled debt that was qualified principal residence indebtedness. Although Nancy has \$440,000 of qualified principal residence indebtedness, part of her loan (\$35,000) was not qualified principal residence indebtedness because it was used to pay off personal credit cards and college tuition for her son. Applying the ordering rule, the qualified principal

residence indebtedness exclusion applies only to the extent the amount canceled is more than the amount of the debt (immediately before the cancellation) that is **not** qualified principal residence indebtedness. Thus, Nancy can exclude only \$5,000 of the canceled debt as qualified principal residence indebtedness (\$40,000 amount canceled minus \$35,000 nonqualified debt).

Because Nancy does not meet any other exception or exclusion, Nancy checks only the

box on line 1e of Form 982 and enters \$5,000 on line 2. Nancy must also enter \$5,000 on line 10b and reduce the basis of her main home by the \$5,000 she excluded from income, bringing the adjusted basis in her home to \$460,000 (\$435,000 purchase price plus \$30,000 substantial improvement minus \$5,000). Nancy must also include the \$35,000 nonqualified debt portion in income on Form 1040, line 21.

Following are Nancy's sample forms.

CORRECTED (if checked)

CREDITOR'S name, street address, city, state, ZIP code, and telephone no. <i>Goodold Bank 54 Happy Street Anytown, FL 00000</i>		1 Date canceled <i>8-31-2011</i>	OMB No. 1545-1424 2011 Form 1099-C	Cancellation of Debt
		2 Amount of debt canceled <i>\$40,000.00</i>		
		3 Interest if included in box 2 \$		
CREDITOR'S federal identification number <i>10-6543210</i>	DEBTOR'S identification number <i>123-00-6789</i>	4 Debt description <i>Home mortgage loan</i>		Copy B For Debtor This is important tax information and is being furnished to the Internal Revenue Service. 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 <i>Nancy Oak</i>		5 If checked, the debtor was personally liable for repayment of the debt <input checked="" type="checkbox"/>		
Street address (including apt. no.) <i>360 Degree Circle City, state, and ZIP code Anyplace, FL 00000</i>		6 Bankruptcy (if checked) <input type="checkbox"/>		
Account number (see instructions)		7 Fair market value of property \$		

Form **1099-C** (keep for your records) Department of the Treasury - Internal Revenue Service

If you did not get a W-2, see instructions.	14 Other gains or (losses). Attach Form 4797				
Enclose, but do not attach, any payment. Also, please use Form 1040-V .	15a IRA distributions				
	16a Pensions and annuities				
	17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E				
	18 Farm income or (loss). Attach Schedule F				
	19 Unemployment compensation				
	20a Social security benefits				
	21 Other income. List type and amount <i>Cancellation of debt</i>			<i>35,000</i>	<i>00</i>
	22 Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶				
Adjusted Gross Income	23 Educator expenses				
	24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ				
	25 Health savings account deduction. Attach Form 8889				
	26 Moving expenses. Attach Form 3903				
	27 Deductible part of self-employment tax. Attach Schedule SE				
	28 Self-employed SEP, SIMPLE, and qualified plans				

Form **1040** (2011)

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

OMB No. 1545-0046

▶ Attach this form to your income tax return.

Attachment
 Sequence No. **94**

Name shown on return

Identifying number

Nancy Oak

123-00-6789

Part I General Information (see instructions)

- 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
- 2** Total amount of discharged indebtedness excluded from gross income **2** 5,000.00
- 3** Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? Yes No

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. Enter amount here ONLY if line 1e is checked	10b	5000.00
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	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded \$ _____ from its gross income for the tax year beginning _____ and ending _____.

Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of _____.

(State of incorporation)

Note. You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

For Paperwork Reduction Act Notice, see page 5 of this form.

Cat. No. 17066E

Form **982** (Rev. 2-2011)

Example 2—Mortgage loan foreclosure. In 2003, John and Mary Elm bought a main home for \$335,000. John and Mary took out a \$320,000 mortgage loan to buy the home and made a down payment of \$15,000. The loan was secured by the home and is a recourse debt, meaning John and Mary are personally liable for the debt.

John and Mary became unable to make their mortgage loan payments and on March 1, 2011, when the outstanding balance of the mortgage loan was \$315,000 and the FMV of the property was \$290,000, the bank foreclosed on the property and simultaneously canceled the remaining mortgage debt. Immediately before the foreclosure, John and Mary's only other assets and liabilities were a checking account with a balance of \$6,000, retirement savings of \$13,000, and credit card debt of \$5,500.

John and Mary received a 2011 Form 1099-C showing canceled debt of \$25,000 in box 2 (\$315,000 outstanding balance minus \$290,000 FMV) and an FMV of \$290,000 in box 7. In order to determine if John and Mary must

include the canceled debt in income, they must first determine whether they meet any of the exceptions or exclusions that apply to canceled debts. In this example, John and Mary meet both the insolvency and qualified principal residence indebtedness exclusions.

John and Mary complete the insolvency worksheet and determine that they were insolvent immediately before the cancellation because at that time their liabilities exceeded the FMV of their assets by \$11,500 (\$320,500 total liabilities minus \$309,000 FMV of total assets). However, because the entire debt canceled is qualified principal residence indebtedness, the insolvency exclusion only applies if John and Mary elect to apply the insolvency exclusion instead of the qualified principal residence exclusion.

John and Mary do not elect to apply the insolvency exclusion instead of the qualified principal residence exclusion because under the insolvency exclusion their exclusion would be limited to the amount by which they were insolvent (\$11,500). Instead, John and Mary check

box 1e of Form 982 to exclude the canceled debt under the qualified principal residence exclusion. Under the qualified principal residence exclusion, the amount that John and Mary can exclude is not limited because their qualified principal residence indebtedness is not more than \$2 million and no portion of the loan was nonqualified debt. As a result, John and Mary enter the full \$25,000 of canceled debt on line 2 of Form 982. Because John and Mary no longer own the home due to the foreclosure, John and Mary have no remaining basis in the home at the time of the debt cancellation. Thus, John and Mary leave line 10b of Form 982 blank.

John and Mary must also determine whether they have a gain or loss from the foreclosure. John and Mary complete [Table 1-1](#) and find that they have a \$45,000 loss from the foreclosure. Because this loss relates to their home, it is a nondeductible loss.

Following are John and Mary's sample forms and worksheets.

CORRECTED (if checked)

CREDITOR'S name, street address, city, state, ZIP code, and telephone no. Birch Bank 76 Spruce Lane Treetown, KS 00000		1 Date canceled 3-1-2011	OMB No. 1545-1424	2011	Cancellation of Debt
		2 Amount of debt canceled \$25,000.00	Form 1099-C		
		3 Interest if included in box 2 \$			
CREDITOR'S federal identification number 10-7890123	DEBTOR'S identification number 234-00-7890	4 Debt description Home mortgage loan			Copy B For Debtor This is important tax information and is being furnished to the Internal Revenue Service. 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 John and Mary Elm		5 If checked, the debtor was personally liable for repayment of the debt <input checked="" type="checkbox"/>			
Street address (including apt. no.) 11 Siberian Street City, state, and ZIP code Treetown, KS 00000					
Account number (see instructions) 505050		6 Bankruptcy (if checked) <input type="checkbox"/>	7 Fair market value of property \$ 290,000.00		

Form **1099-C**

(keep for your records)

Department of the Treasury - Internal Revenue Service

Table 1-1. Worksheet for Foreclosures and Repossessions (for John and Mary Elm)

Part 1. Complete Part 1 only if you were personally liable for the debt (even if none of the debt was canceled). Otherwise, go to Part 2.	
1. Enter the amount of outstanding debt immediately before the transfer of property reduced by any amount for which you remain personally liable immediately after the transfer of property	\$315,000.00
2. Enter the fair market value of the transferred property	\$290,000.00
3. Ordinary income from the cancellation of debt upon foreclosure or repossession.* Subtract line 2 from line 1. If less than zero, enter zero. Next, go to Part 2	<u>\$ 25,000.00</u>
Part 2. Gain or loss from foreclosure or repossession.	
4. Enter the smaller of line 1 or line 2. If you did not complete Part 1 (because you were not personally liable for the debt), enter the amount of outstanding debt immediately before the transfer of property	\$290,000.00
5. Enter any proceeds you received from the foreclosure sale	_____
6. Add line 4 and line 5	\$290,000.00
7. Enter the adjusted basis of the transferred property	\$335,000.00
8. Gain or loss from foreclosure or repossession. Subtract line 7 from line 6	<u>(\$ 45,000.00)</u>
* The income may not be taxable. See chapter 1 for more details.	

Insolvency Worksheet—John and Mary Elm

Keep for Your Records



Date debt was canceled (mm/dd/yy)	03/01/11
Part I. Total liabilities immediately before the cancellation (do not include the same liability in more than one category)	
<u>Liabilities (debts)</u>	<u>Amount Owed Immediately Before the Cancellation</u>
1. Credit card debt	\$ 5,500
2. Mortgage(s) on real property (including first and second mortgages and home equity loans) (mortgage(s) can be on personal residence, any additional residence, or property held for investment or used in a trade or business)	\$ 315,000
3. Car and other vehicle loans	\$
4. Medical bills owed	\$
5. Student loans	\$
6. Accrued or past-due mortgage interest	\$
7. Accrued or past-due real estate taxes	\$
8. Accrued or past-due utilities (water, gas, electric)	\$
9. Accrued or past-due child care costs	\$
10. Federal or state income taxes remaining due (for prior tax years)	\$
11. Judgments	\$
12. Business debts (including those owed as a sole proprietor or partner)	\$
13. Margin debt on stocks and other debt to purchase or secured by investment assets other than real property	\$
14. Other liabilities (debts) not included above	\$
15. Total liabilities immediately before the cancellation. Add lines 1 through 14.	\$ 320,500
Part II. Fair market value (FMV) of assets owned immediately before the cancellation (do not include the FMV of the same asset in more than one category)	
<u>Assets</u>	<u>FMV Immediately Before the Cancellation</u>
16. Cash and bank account balances	\$ 6,000
17. Homes (including the value of land) (can be main home, any additional home, or property held for investment or used in a trade or business)	\$ 290,000
18. Cars and other vehicles	\$
19. Computers	\$
20. Household goods and furnishings (for example, appliances, electronics, furniture, etc.)	\$
21. Tools	\$
22. Jewelry	\$
23. Clothing	\$
24. Books	\$
25. Stocks and bonds	\$
26. Investments in coins, stamps, paintings, or other collectibles	\$
27. Firearms, sports, photographic, and other hobby equipment	\$
28. Interest in retirement accounts (IRA accounts, 401(k) accounts, and other retirement accounts)	\$ 13,000
29. Interest in a pension plan	\$
30. Interest in education accounts	\$
31. Cash value of life insurance	\$
32. Security deposits with landlords, utilities, and others	\$
33. Interests in partnerships	\$
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.	\$ 309,000
Part III. Insolvency	
38. Amount of insolvency. Subtract line 37 from line 15. If zero or less, you are not insolvent.	\$ 11,500

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

OMB No. 1545-0046

▶ Attach this form to your income tax return.

Attachment
 Sequence No. **94**

Name shown on return

Identifying number

John and Mary Elm

234-00-7890

Part I General Information (see instructions)

- 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
- 2** Total amount of discharged indebtedness excluded from gross income **2** 25,000.00
- 3** Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? Yes No

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	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded \$ _____ from its gross income for the tax year beginning _____ and ending _____.

Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of _____.

(State of incorporation)

Note. You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

For Paperwork Reduction Act Notice, see page 5 of this form.

Cat. No. 17066E

Form **982** (Rev. 2-2011)

Example 3—Mortgage loan foreclosure with debt exceeding \$2 million limit. In 2009, Kathy and Frank Willow got married and entered into a contract with Hive Construction Corporation to build a house for \$3,000,000 to be used as their main home. Kathy and Frank made a \$400,000 down payment and took out a \$2,600,000 mortgage to finance the remaining cost of the house. Kathy and Frank are personally liable for the mortgage loan, which is secured by the home.

In November 2011, when the outstanding principal balance on the mortgage loan was \$2,500,000, the FMV of the property fell to \$1,750,000 and Kathy and Frank abandoned the property by permanently moving out. The lender foreclosed on the property and, on December 5, 2011, sold the property to another buyer for \$1,750,000. On December 26, 2011, the lender canceled the remaining debt. Kathy and Frank have no tax attributes other than basis of personal-use property.

The lender issued a 2011 Form 1099-C to Kathy and Frank showing canceled debt of \$750,000 in box 2 (the remaining balance on the \$2,500,000 mortgage debt after application of the foreclosure sale proceeds) and \$1,750,000 in box 7 (FMV of the property). Although Kathy and Frank abandoned the property, the lender did not need to also file a Form 1099-A because the lender canceled the debt in connection with the foreclosure in the same calendar year. Kathy and Frank are filing a joint return for 2011.

Because the foreclosure occurred prior to the debt cancellation, Kathy and Frank first calculate their gain or loss from the foreclosure using [Table 1-1](#). Because Kathy and Frank remained personally liable for the \$750,000 debt remaining after the foreclosure (\$2,500,000 outstanding debt immediately before the foreclosure minus \$1,750,000 satisfied through the sale of the home), Kathy and Frank enter \$1,750,000 on line 1 of [Table 1-1](#) (\$2,500,000 outstanding debt immediately before the foreclosure minus the \$750,000 for which they remained liable). Completing [Table 1-1](#), Kathy and Frank find that they have no ordinary income from the cancellation of debt upon foreclosure and that they have a \$1,250,000 loss. Because this loss relates to their home, it is a nondeductible loss.

Because the lender later canceled the remaining amount of the debt, Kathy and Frank must also determine whether that canceled debt is taxable. Immediately before the cancellation, Kathy and Frank had \$15,000 in a savings account, household furnishings with an FMV of

\$17,000, a car with an FMV of \$10,000, and \$18,000 in credit card debt. Kathy and Frank also had the \$750,000 remaining balance on the mortgage loan at that time. The household furnishings originally cost \$30,000. The car had been fully paid off (so there was no related outstanding debt) and was originally purchased for \$16,000. Kathy and Frank had no adjustments to the cost basis of the car. Kathy and Frank had no other assets or liabilities at the time of the cancellation. Kathy and Frank complete the insolvency worksheet to calculate that they were insolvent to the extent of \$726,000 immediately before the cancellation (\$768,000 of total liabilities minus \$42,000 FMV of total assets).

At the beginning of 2012, Kathy and Frank had \$9,000 in their savings account and \$15,000 in credit card debt. Kathy and Frank also owned the same car at that time (still with an FMV of \$10,000 and basis of \$16,000) and the same household furnishings (still with an FMV of \$17,000 and a basis of \$30,000). Kathy and Frank had no other assets or liabilities at that time. Kathy and Frank no longer own the home because the lender foreclosed on it in 2011.

The insolvency exclusion does not apply if the indebtedness is qualified principal residence indebtedness unless Kathy and Frank elect to apply the insolvency exclusion instead of the qualified principal residence indebtedness exclusion. The maximum amount that Kathy and Frank can treat as qualified principal residence indebtedness is \$2,000,000. The remaining \$500,000 (\$2,500,000 outstanding mortgage loan minus \$2,000,000 limit on qualified principal residence indebtedness) is **not** qualified principal residence indebtedness. Because only a part of the loan is qualified principal residence indebtedness, Kathy and Frank must apply the ordering rule to the canceled debt. Under the ordering rule, the qualified principal residence indebtedness exclusion applies only to the extent that the amount canceled (\$750,000) exceeds the amount of the loan (immediately before the cancellation) that is **not** qualified principal residence indebtedness (\$500,000). This means that Kathy and Frank can only exclude \$250,000 (\$750,000 amount canceled minus \$500,000 nonqualified debt) under the qualified principal residence indebtedness exclusion.

Kathy and Frank do not elect to have the insolvency exclusion apply instead of the qualified principal residence exclusion. Nonetheless, they can still apply the insolvency exclusion to the \$500,000 nonqualified debt because such

debt is not qualified principal residence indebtedness. Kathy and Frank can exclude the remaining \$500,000 canceled debt under the insolvency exclusion because they were insolvent immediately before the cancellation to the extent of \$726,000. Thus, Kathy and Frank check the boxes on lines 1b and 1e of Form 982 and enter \$750,000 on line 2 (\$250,000 excluded under the qualified principal residence indebtedness exclusion plus \$500,000 excluded under the insolvency exclusion).

Next, Kathy and Frank reduce their tax attributes using Part II of Form 982. Because Kathy and Frank no longer own the home due to the foreclosure, Kathy and Frank have no remaining basis in the home at the time of the debt cancellation. Thus, Kathy and Frank leave line 10b of Form 982 blank. However, Kathy and Frank are also excluding nonqualified debt under the insolvency exclusion. As a result, Kathy and Frank must reduce the basis of property they own based on the amount of canceled debt they are excluding from income under the insolvency rules. Because Kathy and Frank have no tax attributes other than basis of personal-use property to reduce, Kathy and Frank figure the amount they must include on line 10a of Form 982 by taking the smallest of:

- The \$46,000 bases of their personal-use property held at the beginning of 2012 (\$16,000 basis in the car plus \$30,000 basis in household furnishings),
- The \$500,000 of the nonbusiness debt (other than qualified principal residence indebtedness) that they are excluding from income on line 2 of Form 982, or
- The \$43,000 excess of the total bases of the property and the amount of money they held immediately after the cancellation over their total liabilities immediately after the cancellation (\$15,000 in savings account plus \$30,000 basis in household furnishings plus \$16,000 adjusted basis in car minus \$18,000 credit card debt).

Kathy and Frank enter \$43,000 on Form 982, line 10a and reduce their bases in the car and the household furnishings in proportion to the adjusted bases in all their property. Kathy and Frank reduce the basis in the car by \$14,956.52 (\$43,000 x \$16,000/\$46,000). And they reduce the basis in the household furnishings by \$28,043.48 (\$43,000 x \$30,000/\$46,000).

Following are Kathy and Frank's sample forms and worksheets.

Insolvency Worksheet—Frank and Kathy Willow

Keep for Your Records



Date debt was canceled (mm/dd/yy)	12/26/11
Part I. Total liabilities immediately before the cancellation (do not include the same liability in more than one category)	
<u>Liabilities (debts)</u>	<u>Amount Owed Immediately Before the Cancellation</u>
1. Credit card debt	\$ 18,000
2. Mortgage(s) on real property (including first and second mortgages and home equity loans) (mortgage(s) can be on personal residence, any additional residence, or property held for investment or used in a trade or business)	\$ 750,000
3. Car and other vehicle loans	\$
4. Medical bills owed	\$
5. Student loans	\$
6. Accrued or past-due mortgage interest	\$
7. Accrued or past-due real estate taxes	\$
8. Accrued or past-due utilities (water, gas, electric)	\$
9. Accrued or past-due child care costs	\$
10. Federal or state income taxes remaining due (for prior tax years)	\$
11. Judgments	\$
12. Business debts (including those owed as a sole proprietor or partner)	\$
13. Margin debt on stocks and other debt to purchase or secured by investment assets other than real property	\$
14. Other liabilities (debts) not included above	\$
15. Total liabilities immediately before the cancellation. Add lines 1 through 14.	\$ 768,000
Part II. Fair market value (FMV) of assets owned immediately before the cancellation (do not include the FMV of the same asset in more than one category)	
<u>Assets</u>	<u>FMV Immediately Before the Cancellation</u>
16. Cash and bank account balances	\$ 15,000
17. Homes (including the value of land) (can be main home, any additional home, or property held for investment or used in a trade or business)	\$
18. Cars and other vehicles	\$ 10,000
19. Computers	\$
20. Household goods and furnishings (for example, appliances, electronics, furniture, etc.)	\$ 17,000
21. Tools	\$
22. Jewelry	\$
23. Clothing	\$
24. Books	\$
25. Stocks and bonds	\$
26. Investments in coins, stamps, paintings, or other collectibles	\$
27. Firearms, sports, photographic, and other hobby equipment	\$
28. Interest in retirement accounts (IRA accounts, 401(k) accounts, and other retirement accounts)	\$
29. Interest in a pension plan	\$
30. Interest in education accounts	\$
31. Cash value of life insurance	\$
32. Security deposits with landlords, utilities, and others	\$
33. Interests in partnerships	\$
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.	\$ 42,000
Part III. Insolvency	
38. Amount of insolvency. Subtract line 37 from line 15. If zero or less, you are not insolvent.	\$ 726,000

CORRECTED (if checked)

CREDITOR'S name, street address, city, state, ZIP code, and telephone no. Bumble Bank 5 Market Street Buzztown, NJ 07000		1 Date canceled 12-26-2011	OMB No. 1545-1424 2011 Form 1099-C	Cancellation of Debt
		2 Amount of debt canceled \$750,000.00		
		3 Interest if included in box 2 \$		
CREDITOR'S federal identification number 10-7654321	DEBTOR'S identification number 987-00-4321	4 Debt description Home mortgage loan		Copy B For Debtor This is important tax information and is being furnished to the Internal Revenue Service. 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 Frank and Kathy Willow Street address (including apt. no.) 21 Honeytree Lane, Apt. 5B City, state, and ZIP code Buzztown, NJ 07000		5 If checked, the debtor was personally liable for repayment of the debt <input checked="" type="checkbox"/>		
Account number (see instructions) 5551212	6 Bankruptcy (if checked) <input type="checkbox"/>	7 Fair market value of property \$ 1,750,000.00		
Form 1099-C		(keep for your records)		Department of the Treasury - Internal Revenue Service

Table 1-1. Worksheet for Foreclosures and Repossessions (for Frank and Kathy Willow)

Part 1. Complete Part 1 only if you were personally liable for the debt (even if none of the debt was canceled). Otherwise, go to Part 2.	
1. Enter the amount of outstanding debt immediately before the transfer of property reduced by any amount for which you remain personally liable immediately after the transfer of property	\$1,750,000.00
2. Enter the fair market value of the transferred property	\$1,750,000.00
3. Ordinary income from the cancellation of debt upon foreclosure or repossession.* Subtract line 2 from line 1. If less than zero, enter zero. Next, go to Part 2	\$0.00
Part 2. Gain or loss from foreclosure or repossession.	
4. Enter the smaller of line 1 or line 2. If you did not complete Part 1 (because you were not personally liable for the debt), enter the amount of outstanding debt immediately before the transfer of property.	\$1,750,000.00
5. Enter any proceeds you received from the foreclosure sale	_____
6. Add line 4 and line 5	\$1,750,000.00
7. Enter the adjusted basis of the transferred property	\$3,000,000.00
8. Gain or loss from foreclosure or repossession. Subtract line 7 from line 6	(\$1,250,000.00)
* The income may not be taxable. See chapter 1 for more details.	

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

OMB No. 1545-0046

▶ Attach this form to your income tax return.

Attachment
 Sequence No. **94**

Name shown on return

Identifying number

Frank and Kathy Willow

987-00-4321

Part I General Information (see instructions)

- 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
- 2** Total amount of discharged indebtedness excluded from gross income **2** 750,000.00
- 3** Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? Yes No

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	43,000.00
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	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded \$ _____ from its gross income for the tax year beginning _____ and ending _____.

Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of _____.

(State of incorporation)

Note. You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

5.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Free help with your return. Free help in preparing your return is available nationwide from IRS-certified volunteers. The Volunteer Income Tax Assistance (VITA) program is designed to help low-moderate income taxpayers and the Tax Counseling for the Elderly (TCE) program is designed to assist taxpayers age 60 and older with their tax returns. Most VITA and TCE sites offer free electronic filing and all volunteers will let you know about credits and deductions you may be entitled to claim. To find the nearest VITA or TCE site, visit IRS.gov or call 1-800-906-9887 or 1-800-829-1040.

As part of the TCE program, AARP offers the Tax-Aide counseling program. To find the nearest AARP Tax-Aide site, call 1-888-227-7669 or visit AARP's website at www.aarp.org/money/taxaide.

For more information on these programs, go to IRS.gov and enter keyword "VITA" in the upper right-hand corner.



Internet. You can access the IRS website at IRS.gov 24 hours a day, 7 days a week to:

- **E-file** your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2011 refund. Go to IRS.gov and click on *Where's My Refund*. Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2011 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund.
- Download forms, including talking tax forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- Use the online Internal Revenue Code, regulations, or other official guidance.
- View Internal Revenue Bulletins (IRBs) published in the last few years.
- Figure your withholding allowances using the withholding calculator online at www.irs.gov/individuals.

- Determine if Form 6251 must be filed by using our Alternative Minimum Tax (AMT) Assistant available online at www.irs.gov/individuals.
- Sign up to receive local and national tax news by email.
- Get information on starting and operating a small business.



Phone. Many services are available by phone.

- **Ordering forms, instructions, and publications.** Call 1-800-TAX-FORM (1-800-829-3676) to order current-year forms, instructions, and publications, and prior-year forms and instructions. You should receive your order within 10 days.
- **Asking tax questions.** Call the IRS with your tax questions at 1-800-829-1040.
- **Solving problems.** You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service*.
- **TTY/TDD equipment.** If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- **TeleTax topics.** Call 1-800-829-4477 to listen to pre-recorded messages covering various tax topics.
- **Refund information.** To check the status of your 2011 refund, call 1-800-829-1954 or 1-800-829-4477 (automated refund information 24 hours a day, 7 days a week). Wait at least 72 hours after the IRS acknowledges receipt of your e-filed return, or 3 to 4 weeks after mailing a paper return. If you filed Form 8379 with your return, wait 14 weeks (11 weeks if you filed electronically). Have your 2011 tax return available so you can provide your social security number, your filing status, and the exact whole dollar amount of your refund. If you check the status of your refund and are not given the date it will be issued, please wait until the next week before checking back.
- **Other refund information.** To check the status of a prior-year refund or amended return refund, call 1-800-829-1040.

Evaluating the quality of our telephone services. To ensure IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to listen in on or record random telephone calls. Another is to ask some callers to complete a short survey at the end of the call.



Walk-in. Many products and services are available on a walk-in basis.

- **Products.** You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- **Services.** You can walk in to your local Taxpayer Assistance Center every business day for personal, face-to-face tax help. An employee can explain IRS letters, request adjustments to your tax account, or help you set up a payment plan. If you need to resolve a tax problem, have questions about how the tax law applies to your individual tax return, or you are more comfortable talking with someone in person, visit your local Taxpayer Assistance Center where you can spread out your records and talk with an IRS representative face-to-face. No appointment is necessary—just walk in. If you prefer, you can call your local Center and leave a message requesting an appointment to resolve a tax account issue. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. If you have an ongoing, complex tax account problem or a special need, such as a disability, an appointment can be requested. All other issues will be handled without an appointment. To find the number of your local office, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service*.



Mail. You can send your order for forms, instructions, and publications to the address below. You should receive a response within 10 days after your request is received.

Internal Revenue Service
1201 N. Mitsubishi Motorway
Bloomington, IL 61705-6613

Taxpayer Advocate Service. The Taxpayer Advocate Service (TAS) is your voice at the IRS. Our job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights. We offer free help to guide you through the often-confusing process of resolving tax problems that you haven't been able to solve on your own. Remember, the worst thing you can do is nothing at all.

TAS can help if you can't resolve your problem with the IRS and:

- Your problem is causing financial difficulties for you, your family, or your business.
- You face (or your business is facing) an immediate threat of adverse action.

- You have tried repeatedly to contact the IRS but no one has responded, or the IRS has not responded to you by the date promised.

If you qualify for our help, we'll do everything we can to get your problem resolved. You will be assigned to one advocate who will be with you at every turn. We have offices in every state, the District of Columbia, and Puerto Rico. Although TAS is independent within the IRS, our advocates know how to work with the IRS to get your problems resolved. And our services are always free.

As a taxpayer, you have rights that the IRS must abide by in its dealings with you. Our tax toolkit at www.TaxpayerAdvocate.irs.gov can help you understand these rights.

If you think TAS might be able to help you, call your local advocate, whose number is in your phone book and on our website at www.irs.gov/advocate. You can also call our toll-free number at 1-877-777-4778 or TTY/TDD 1-800-829-4059.

TAS also handles large-scale or systemic problems that affect many taxpayers. If you know of one of these broad issues, please report it to us through our Systemic Advocacy Management System at www.irs.gov/advocate.

Low Income Taxpayer Clinics (LITCs). Low Income Taxpayer Clinics (LITCs) are independent from the IRS. Some clinics serve individuals whose income is below a certain level and who need to resolve a tax problem. These clinics provide professional representation

before the IRS or in court on audits, appeals, tax collection disputes, and other issues for free or for a small fee. Some clinics can provide information about taxpayer rights and responsibilities in many different languages for individuals who speak English as a second language. For more information and to find a clinic near you, see the LITC page on www.irs.gov/advocate or IRS Publication 4134, *Low Income Taxpayer Clinic List*. This publication is also available by calling 1-800-829-3676 or at your local IRS office.

Free tax services. Publication 910, *IRS Guide to Free Tax Services*, is your guide to IRS services and resources. Learn about free tax information from the IRS, including publications, services, and education and assistance programs. The publication also has an index of over 100 TeleTax topics (recorded tax information) you can listen to on the telephone. The majority of the information and services listed in this publication are available to you free of charge. If there is a fee associated with a resource or service, it is listed in the publication.

Accessible versions of IRS published products are available on request in a variety of alternative formats for people with disabilities.



DVD for tax products. You can order Publication 1796, *IRS Tax Products DVD*, and obtain:

- Current-year forms, instructions, and publications.

- Prior-year forms, instructions, and publications.
- Tax Map: an electronic research tool and finding aid.
- Tax law frequently asked questions.
- Tax Topics from the IRS telephone response system.
- Internal Revenue Code—Title 26 of the U.S. Code.
- Links to other Internet based Tax Research Materials.
- Fill-in, print, and save features for most tax forms.
- Internal Revenue Bulletins.
- Toll-free and email technical support.
- Two releases during the year.
 - The first release will ship the beginning of January 2012.
 - The final release will ship the beginning of March 2012.

Purchase the DVD from National Technical Information Service (NTIS) at www.irs.gov/cdorders for \$30 (no handling fee) or call 1-877-233-6767 toll free to buy the DVD for \$30 (plus a \$6 handling fee).



501(c)(3) organizations 4	Definitions:	I	Qualified principal residence indebtedness 8
A	Adjusted tax attributes 5	Income from canceled debt 2	Reduction of tax attributes 8
Abandonments 3, 11	Main home 8	Insolvency 4	Qualified real property business indebtedness 7
Canceled debt 12	Qualified acquisition indebtedness 7	Reduction of tax attributes 8	Reduction of tax attributes 10
Assistance (See Tax help)	Qualified farm indebtedness 5	Interest:	
B	Qualified principal residence indebtedness 8	Canceled debt including 3	
Bankruptcy 4	Qualified real property business indebtedness 7	L	
Reduction of tax attributes 8	Discounts:	Limits:	
Business:	Mortgage loan for early payment 3	Excluded farm debt 5	Real property business indebtedness 7
Real property indebtedness 7	E	Excluded principal residence indebtedness 8	Recapture:
C	Educational loans 3	Qualified real property business indebtedness 7	Basis reductions 9
Canceled debt:	Exceptions:	Loans (See also Mortgage) 3	Repossessions 10
Co-owners 3	Home Affordable Modification Program 4	Student 3	S
Exceptions:	F	M	Sales or other dispositions 3
Deductible debt 4	Farm indebtedness 5	Missing children, photographs of 1	Stockholder debts 3
Gifts 3	Reduction of tax attributes 9	More information (See Tax help)	Student loans 3
Price reduced after purchase 4	Foreclosures 3, 10	Mortgage:	
Student loans 3	Form:	Discounted loan 3	
Exclusions:	1099-A 11, 12	P	
Bankruptcy 4	1099-C 3, 11, 12	Principal residence indebtedness 8	
Insolvency 4	Free tax services 23	Publications (See Tax help)	
Qualified farm indebtedness 5	G		
Qualified principal residence indebtedness 8	Gifts 3	Q	
Qualified real property business indebtedness 7	H	Qualified farm indebtedness 5	
Income from 2	Help (See Tax help)	Reduction of tax attributes 9	
D	Home Affordable Modification Program 4		
Debts:			
Stockholder's 3			

Tax Publications for Individual Taxpayers See *How To Get Tax Help* for a variety of ways to get publications, including by computer, phone, and mail.

General Guides		531 Reporting Tip Income	908 Bankruptcy Tax Guide	
1	Your Rights as a Taxpayer	535 Business Expenses	915 Social Security and Equivalent Railroad Retirement Benefits	
17	Your Federal Income Tax For Individuals	536 Net Operating Losses (NOLs) for Individuals, Estates, and Trusts	925 Passive Activity and At-Risk Rules	
334	Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)	537 Installment Sales	926 Household Employer's Tax Guide For Wages Paid in 2012	
509	Tax Calendars for 2012	541 Partnerships	929 Tax Rules for Children and Dependents	
910	IRS Guide to Free Tax Services	544 Sales and Other Dispositions of Assets	936 Home Mortgage Interest Deduction	
Specialized Publications		547 Casualties, Disasters, and Thefts	946 How To Depreciate Property	
3	Armed Forces' Tax Guide	550 Investment Income and Expenses (Including Capital Gains and Losses)	947 Practice Before the IRS and Power of Attorney	
54	Tax Guide for U.S. Citizens and Resident Aliens Abroad	551 Basis of Assets	950 Introduction to Estate and Gift Taxes	
225	Farmer's Tax Guide	554 Tax Guide for Seniors	969 Health Savings Accounts and Other Tax-Favored Health Plans	
463	Travel, Entertainment, Gift, and Car Expenses	555 Community Property	970 Tax Benefits for Education	
501	Exemptions, Standard Deduction, and Filing Information	556 Examination of Returns, Appeal Rights, and Claims for Refund	971 Innocent Spouse Relief	
502	Medical and Dental Expenses (Including the Health Coverage Tax Credit)	559 Survivors, Executors, and Administrators	972 Child Tax Credit	
503	Child and Dependent Care Expenses	561 Determining the Value of Donated Property	1542 Per Diem Rates (For Travel Within the Continental United States)	
504	Divorced or Separated Individuals	570 Tax Guide for Individuals With Income From U.S. Possessions	1544 Reporting Cash Payments of Over \$10,000 (Received in a Trade or Business)	
505	Tax Withholding and Estimated Tax	571 Tax-Sheltered Annuity Plans (403(b) Plans) For Employees of Public Schools and Certain Tax-Exempt Organizations	1546 Taxpayer Advocate Service – Your Voice at the IRS	
514	Foreign Tax Credit for Individuals	575 Pension and Annuity Income	Spanish Language Publications	
516	U.S. Government Civilian Employees Stationed Abroad	584 Casualty, Disaster, and Theft Loss Workbook (Personal-Use Property)	1SP Derechos del Contribuyente	
517	Social Security and Other Information for Members of the Clergy and Religious Workers	587 Business Use of Your Home (Including Use by Daycare Providers)	17(SP) El Impuesto Federal sobre los Ingresos Para Personas Físicas	
519	U.S. Tax Guide for Aliens	590 Individual Retirement Arrangements (IRAs)	547(SP) Hechos Fortuitos Desastres y Robos	
521	Moving Expenses	594 The IRS Collection Process	584(SP) Registro de Pérdidas por Hechos Fortuitos (Imprevistos), Desastres y Robos (Propiedad de Uso Personal)	
523	Selling Your Home	596 Earned Income Credit (EIC)	594SP El Proceso de Cobro del IRS	
524	Credit for the Elderly or the Disabled	721 Tax Guide to U.S. Civil Service Retirement Benefits	596SP Crédito por Ingreso del Trabajo	
525	Taxable and Nontaxable Income	901 U.S. Tax Treaties	850(EN/SP) English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service	
526	Charitable Contributions	907 Tax Highlights for Persons with Disabilities	1544 (SP) Informe de Pagos en Exceso de \$10,000 (Recibidos en una Ocupación o Negocio)	
527	Residential Rental Property (Including Rental of Vacation Homes)			
529	Miscellaneous Deductions			
530	Tax Information for Homeowners			

Commonly Used Tax Forms See *How To Get Tax Help* for a variety of ways to get forms, including by computer, phone, and mail.

Form Number and Title			
1040	U.S. Individual Income Tax Return	2441	Child and Dependent Care Expenses
Sch A	Itemized Deductions	2848	Power of Attorney and Declaration of Representative
Sch B	Interest and Ordinary Dividends	2848(SP)	Poder Legal y Declaración del Representante
Sch C	Profit or Loss From Business	3903	Moving Expenses
Sch C-EZ	Net Profit From Business	4562	Depreciation and Amortization
Sch D	Capital Gains and Losses	4868	Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
Sch E	Supplemental Income and Loss	4868(SP)	Solicitud de Prórroga Automática para Presentar la Declaración del Impuesto sobre el Ingreso Personal de los Estados Unidos
Sch EIC	Earned Income Credit	4952	Investment Interest Expense Deduction
Sch F	Profit or Loss From Farming	5329	Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts
Sch H	Household Employment Taxes	6251	Alternative Minimum Tax—Individuals
Sch J	Income Averaging for Farmers and Fishermen	8283	Noncash Charitable Contributions
Sch R	Credit for the Elderly or the Disabled	8582	Passive Activity Loss Limitations
Sch SE	Self-Employment Tax	8606	Nondeductible IRAs
1040A	U.S. Individual Income Tax Return	8812	Additional Child Tax Credit
Sch B	Interest and Ordinary Dividends	8822	Change of Address
1040EZ	Income Tax Return for Single and Joint Filers With No Dependents	8829	Expenses for Business Use of Your Home
1040-ES	Estimated Tax for Individuals	8863	Education Credits (American Opportunity, and Lifetime Learning Credits)
1040X	Amended U.S. Individual Income Tax Return	8949	Sales and Other Dispositions of Capital Assets
2106	Employee Business Expenses	9465	Installment Agreement Request
2106-EZ	Unreimbursed Employee Business Expenses	9465(SP)	Solicitud para un Plan de Pagos a Plazos
2210	Underpayment of Estimated Tax by Individuals, Estates, and Trusts		