Legislative Extenders

Introduction

The content in this lesson is being provided because these are not considered permanent provisions in the tax law. The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) extended the following provisions through 2016. Publication 4491-X, released in mid-January, will contain any legislative changes to these and any other provisions. Tax law provisions that were made permanent have been removed from this lesson and added to the appropriate tax law lesson in this publication.

How do I handle tuition and fees?

What is the deduction?

Taxpayers can deduct up to $4,000 in qualified tuition and related expenses paid during the tax year. The amount of the deduction is determined by the taxpayer's filing status, modified adjusted gross income (MAGI), and other factors. For the amount of the allowable deduction see the Tuition and Fees Deduction chart in the Legislative Extenders tab of the Volunteer Resource Guide.

> **example**
>
> Leonard, a single taxpayer who had a total income of $24,000, meets all the requirements to take the deduction. He paid $4,427 in tuition and fees. Because his gross income is well below the MAGI limit, he would be able to deduct the maximum amount ($4,000) for his tuition and fees payments.

Who is eligible for this deduction?

The deduction can be claimed for the taxpayer, the taxpayer's spouse (if filing a joint return), and any dependent (for whom the taxpayer claims a dependency exemption) who attended an eligible educational institution during the tax year.

The tuition and fees deduction *cannot* be claimed by married taxpayers who file as Married Filing Separately or by an individual who is a dependent of another taxpayer.

> **example**
>
> Juanita is married but uses the Married Filing Separately status. She cannot deduct tuition and fees.

In order to claim a deduction for expenses paid for a dependent who is the eligible student, the taxpayer must have paid the qualified expenses and claim an exemption for the dependent. If the student is eligible to be claimed as a dependent (even if not actually claimed) and paid his or her own expenses, *no one* can take the adjustment. However, if the student would not qualify as a dependent, he or she can claim the deduction even if tuition and fees were paid by another person. In that case, the student can treat the amounts paid for tuition and fees as a gift.

Taxpayers who are not eligible for the tuition and fees adjustment because of the dependency issue may be eligible for an education tax credit, covered in the Education Credits lesson.

example

Joseph is 30. Although he lives at home and goes to school full time, he earns about $5,000 each year, so his parents cannot claim him as a dependent. Only Joseph can take the tuition and fees adjustment, even if his parents pay his education expenses.

example

Carly is 18 and claimed by her parents as a dependent. She took out student loans and paid all of her own tuition and fees. Carly cannot take the deduction because she is a dependent. Carly's parents can't claim the deduction either because they did not pay the education expenses. Carly's parents should look into the education credits.

What are qualified tuition and fees expenses?

Generally, qualified education expenses are amounts paid for tuition and fees required for the student's enrollment or attendance at an eligible educational institution. It does not matter whether the expenses were paid in cash, by check, credit card, or with borrowed funds.

Qualified education expenses do not include payments for:

- Insurance, room and board, medical expenses (including health fees), transportation, or similar personal, living, or family expenses.
- Course-related books, supplies, nonacademic activities and equipment unless it is paid as a condition of enrollment or attendance
- Any course or other education involving sports, games, hobbies, and noncredit courses unless the course or other education is part of the student's degree program

Ask the taxpayer if the qualified tuition and expenses were offset by distributions from qualified state tuition programs, Coverdell ESAs, or interest from savings bonds used for higher education expenses. Subtract these from the total payments for tuition and fees.

To help you figure the tuition and fees deduction, the taxpayer should have received Form 1098-T, Tuition Statement. Generally, an eligible education institution must send Form 1098-T or a substitute to each enrolled student by January 31. However, the form only reports "amount billed" or "payments received."

Beginning in tax year 2016, the deduction for qualified tuition and related expenses will not be allowed unless the taxpayer receives a statement (Form 1098-T) from the educational institution. The receipt of the statement by a dependent is treated as received by the taxpayer.

CAUTION

Form 1098-T may have incomplete information. You must question the taxpayer to determine the amount of qualified expenses actually paid and adjust this amount by any non-taxable items, such as scholarships or tuition program distributions.

What is an eligible educational institution?

An eligible educational institution is generally any accredited public, nonprofit, or private post-secondary institution eligible to participate in the student aid programs administered by the Department of Education. It includes virtually all accredited public, nonprofit, and privately owned profit-making post-secondary institutions. Taxpayers who do not know if an educational institution is an eligible institution should contact the school or the U.S. Department of Education website.

How do I determine the amount of the deduction?

Use Form 8917, Tuition and Fees Deduction, to figure the MAGI and the resulting deduction amount.

Tax Software Hint: Form 8917, Tuition and Fees Deduction, is automatically completed from data input in the Education Credits screen.

How do I determine the best education benefit for the taxpayer?

If taxpayers claim the tuition and fees adjustment to income, they cannot claim an education tax credit. The education credits include the American Opportunity and Lifetime Learning Credits, discussed in more detail in the Education Credits lesson or Publication 970, Education Benefits.

For most taxpayers, the tax credit is more beneficial than the adjustment. However, it is important to calculate and compare the education benefits to determine which one is better for the taxpayer.

Complete the entire tax return separately using first the tuition and fees deduction, then the education credit. Compare the returns and choose the best one for the taxpayer.

To compare the benefits see the Highlights of Education Tax Benefits chart in the Education Benefits tab of the Volunteer Resource Guide.

TIP

The tuition and fees deduction may affect state income tax returns. Consider the overall income -- both federal and state -- before choosing the best option.

Taxpayer Scenario

Here is how a volunteer helped Glenda deduct the tuition and fees she paid for a class.

SAMPLE INTERVIEW

VOLUNTEER SAYS...	GLENDA RESPONDS...
Let's talk about your education-related expenses. Were you or someone else in your family going to school?	I took one class in the fall.
You're filing as Head of Household and your income is below the limit for taking the full deduction. Do you know how much you paid for tuition?	Yes, I have a copy of my account statement. Will that work?
I see $450 for tuition and $80 for books. Were you required to purchase the books through City College or could you have bought them elsewhere?	Those books were written specifically for the course; I had to purchase them through the school when I registered and they were an enrollment requirement in the course.
OK, then we can include the books. That totals $530. I just need to ask a few more questions. Did you receive any funds from an educational assistance program from your employer?	Yes, the Educational Assistance Program provided $100.
Did you make any tax-free withdrawals from a Coverdell educational savings account or another qualified tuition program, or from U.S. savings bonds?	No.
Did you get any other nontaxable payments, not counting gifts, bequests, or inheritances, that were specifically for educational expenses?	Well, my mom gave me $100 to help with tuition.

SAMPLE INTERVIEW (continued)

The $100 was a gift, so we don't count it. Your total payments were $530 and then we must subtract the $100 employer benefit. You can deduct $430 for tuition and fees. Do you have any questions about all this?	No, I'm really glad I can deduct that.
There is also a credit for people who are paying for college expenses. You can take one or the other, but not both. When we get to the end of the return, I will ask you some more questions to figure out if the credit would be better for you than this deduction.	Okay, I'd appreciate that.
[Note on the intake and interview sheet that you have addressed this adjustment.]	

Itemized Deductions

What about qualified mortgage insurance premiums?

Taxpayers can deduct private mortgage insurance premiums paid or accrued during the current tax year on Schedule A. The insurance must have been in connection with home acquisition debt, and the insurance contract must have been issued after 2006. Volunteers need to be aware that this potential deduction may not be reported on Form 1098. Ask homeowners with a mortgage if they paid mortgage insurance premiums during the tax year. Failure to ask could result in a substantial deduction loss for taxpayers filing Schedule A.

> **TIP**
> Other itemized deductions are discussed in a later lesson.

What are residential energy credits?

Individuals who make purchases for qualified energy efficient improvements for their main home may be allowed nonrefundable tax credits. There are two types of residential energy credits:

- Residential energy efficient property credit (Form 5695, Residential Energy Credits, Part I, which is out of scope for the VITA/TCE programs)
- Nonbusiness energy property credit (Form 5695, Part II)

> **TIP**
> Other credits are discussed in the Miscellaneous Credits lesson.

The IRS provides guidance on what property qualifies for the energy credits, and homeowners generally can rely on manufacturers' certifications. See the Volunteer Resource Guide, Legislative Extenders tab, www.irs.gov, or www.energystar.gov for more information.

Tax Software Hint: Tax software will do all the calculations and enter the total on the appropriate line of Form 1040.

What is the residential energy efficient property credit?

This residential energy credit is claimed on Form 5695, Part I, and is out of scope for the VITA/TCE programs. For awareness only, taxpayers may claim an energy credit for qualified solar electric, solar water heating, small wind energy, and geothermal heat pump property costs. Check for qualifying energy property purchases to determine if the taxpayer should see a professional tax preparer to claim the credit.

What is the nonbusiness energy property credit?

The nonbusiness energy property credit is available for certain qualifying energy efficiency improvements or residential energy property costs. The qualifying items are:

- Biomass stoves
- Heating, ventilating, air-conditioning (HVAC)
- Insulation
- Roofs (metal and asphalt)
- Water heaters (non-solar)
- Windows and doors

The nonbusiness energy property credit is subject to the following limitations:

- The total combined credit limit for all tax years after 2005 is $500, and the combined credit limit for windows is $200.
- The maximum credit for residential energy property costs is $50 for any advanced main air circulating fan; $150 for any qualified natural gas, propane, or oil furnace, or hot water boiler; and $300 for any item of energy efficient building property.

It is important to note that:

- The credit is only available for existing homes that are the taxpayer's main home – new construction and rentals do not qualify. The taxpayer must own the home to qualify.
- Amounts provided by subsidized federal, state, or local energy financing do not qualify for the credit.

CAUTION

Costs for on-site preparation and installation depend on the type of qualified property. Review the Form 5695 Instructions for more information.

Cancellation of Debt (COD)

This lesson will help you recognize when you can help taxpayers who have a canceled debt and when you must refer them elsewhere for help with their tax returns.

Cancellation of Debt – Basics

A debt includes any indebtedness for which a taxpayer is liable or which attaches to the taxpayer's property. Cancellation of indebtedness can involve auto loans, credit card debt, medical care, professional services, installment purchases of furniture or other personal property, mortgages, and home equity loans. Generally, if a debt for which a taxpayer is personally liable is canceled or forgiven, the taxpayer must include the canceled amount in income. There is no income from canceled debt if the cancellation or forgiveness of debt is a gift or bequest.

Use Form 13614-C, Intake/Interview & Quality Review Sheet, to determine if the taxpayer received one or both of Forms 1099-C, Cancellation of Debt, or 1099-A, Acquisition or Abandonment of Secured Property.

In Scope for VITA/TCE Programs

Refer to Publication 4731-A, Screening Sheet for Foreclosures/Abandonments and Cancellation of Debt, to ensure that the tax return being prepared is within scope of the VITA/TCE programs. This screening sheet is contained in the Volunteer Resource Guide, Legislative Extenders tab.

- Use Publication 4731-A, Part I for taxpayers with Form 1099-A for a foreclosure or abandonment of their principal residence
- Use Publication 4731-A, Part II for taxpayers with Form 1099-C, or Forms 1099-A and 1099-C resulting from cancellation of debt on a home mortgage loan

> **TIP**
> Cancellation of credit card debt is included in the Other Income lesson of Publication 4491 for Advanced certification.

Taxability of Canceled Debt

Taxpayers often question the taxability of canceled debt because they did not receive money in hand. In situations where property is surrendered, such as a foreclosure, taxpayers feel that by giving up the property they are relieved from any further obligation. Explain that the benefit to the taxpayer is the relief from personal liability to pay the debt. Information in Publication 17, Your Federal Income Tax for Individuals, can assist with the explanation.

Additional resources include:

- Publication 523, Selling Your Home
- Publication 525, Taxable and Nontaxable Income
- Publication 544, Sales and Other Dispositions of Assets
- Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments

Generally, when debt is canceled, the lender will issue Form 1099-C, Cancellation of Debt, which is then reported as income by the recipients on their tax return. There are exceptions and exclusions to the general rule that determines whether a canceled debt is included as income. This is covered in greater detail later in this lesson.

Recourse vs. Nonrecourse Debt

There are two types of debts: recourse and nonrecourse. A recourse debt holds the borrower personally liable. All other debt is considered nonrecourse.

In general, recourse debt (loans) allows lenders to collect what is owed for the debt even after they've taken collateral (home, credit cards). Lenders have the right to garnish wages or levy accounts in order to collect what is owed.

A nonrecourse debt (loan) does not allow the lender to pursue anything other than the collateral. For example, if a borrower defaults on a nonrecourse home loan, the bank can only foreclose on the home. The bank generally cannot take further legal action to collect the money owed on the debt. Whether a debt is recourse or nonrecourse may vary from state to state, depending on state law.

If a lender cancels a debt and issues Form 1099-C, the lender will indicate on the form if the borrower was personally liable (recourse) for repayment of the debt. Go to www.irs.gov to view Form 1099-C.

> **TIP**
> If property securing the debt was foreclosed on or abandoned, the taxpayer may need to report the disposition (sale) on Form 8949 and Schedule D. This is covered in more detail later in this course.

> **TIP**
> Generally, if taxpayers abandon property that secures debt for which they are **personally liable**, they do not have a gain or loss until the foreclosure is completed.
>
> If taxpayers abandon property that secures debt for which they are **not personally liable**, the abandonment is treated as a sale or exchange.
>
> For more information on abandonments see Publication 4681.

Recourse debt holds the borrower personally liable for any amount not satisfied by the surrender of *secured property*.

- If a lender forecloses on property subject to a recourse debt and cancels the portion of the debt in excess of the fair market value (FMV) of the property, the canceled portion of the debt is treated as ordinary income from cancellation of indebtedness. This amount must be included in gross income unless it qualifies for an exception or exclusion.
- In addition to this cancellation of indebtedness income, the taxpayer may realize a gain or loss on the disposition of the property; this amount is generally the difference between the FMV of the property at the time of the foreclosure and the taxpayer's basis in the property.

Nonrecourse debt is satisfied by the surrender of the *secured property* regardless of the FMV at the time of surrender, and the borrower is not personally liable for the debt.

- If property that is subject to nonrecourse debt is abandoned, foreclosed upon, subject of a short sale, or repossessed by the lender, the circumstances are treated as a sale of the property by the taxpayer.
- In determining the gain or loss on the disposition of the property, the balance of the nonrecourse debt at the time of the disposition of the property is included in the amount realized (generally the selling price). Since the borrower is not personally liable for the debt, the difference between the FMV of the property and the balance of the loan is *not* included in gross income.

	Recourse Debt	Nonrecourse Debt
Borrower is…	Personally liable	Not personally liable
Canceled portion of debt is generally…	Treated as ordinary income and included in gross income (unless it qualifies as an exception or exclusion)	Not applicable. Nonrecourse debt is satisfied by the surrender of the secured property regardless of the FMV at the time of surrender.
Gain or loss on disposition of the property	Generally determined by the difference between the FMV of the property and the adjusted basis	The amount realized includes the balance of the nonrecourse debt at the time of the disposition of the property. This is true even if the FMV of the property is less than the outstanding debt.

example

Jason lost his home to foreclosure because he could no longer make his mortgage payments. At the time of foreclosure, he owed a balance of $170,000 to the lender and the FMV of the property was $140,000.

If Jason is personally liable for the debt (recourse loan), the selling price would be $140,000.

If Jason is not personally liable for the debt (nonrecourse loan), the selling price would be $170,000.

Exceptions and Exclusions

Some canceled or forgiven debts may be *eliminated* from income by applying exceptions, or *reduced* by applying exclusions to the general rule. **Exceptions are applied before exclusions.**

Exceptions

Exceptions may allow the taxpayer to eliminate the following types of canceled debt from income:

- Amounts otherwise excluded from income (e.g., gifts and bequests)
- Certain student loans (e.g., doctors, nurses, and teachers serving in rural or low-income areas)

- Deductible debt (e.g., home mortgage interest that would have been deductible on Schedule A)
- Price reduced after purchase (e.g., debt on solvent taxpayer's property is reduced by the seller; basis of property must be reduced)

For more information on exceptions, refer to Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments.

Exclusions

There are several exclusions from the general rule for reporting canceled debt as income.

Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, must be filed with the taxpayer's return to show the amount of the canceled debt excluded.

The exclusions are:

- Discharge of debt through bankruptcy
- Discharge of debt of insolvent taxpayer
- Discharge of qualified farm indebtedness
- Discharge of qualified real property business indebtedness
- Discharge of qualified principal residence indebtedness

CAUTION

The issues involved in exclusions can be complex. Only cancellation of qualified principal residence indebtedness is within the scope of VITA/TCE.

Cancellation of Debt (COD) – Principal Residence

Mortgage Forgiveness Debt Relief Act 2007

Under the Mortgage Forgiveness Debt Relief Act of 2007, taxpayers may exclude from income certain debt forgiven or canceled on their principal residence. This exclusion is applicable to the discharge of "qualified principal residence indebtedness." If the canceled debt qualifies for exclusion from gross income, the debtor may be required to reduce tax attributes (certain credits, losses, and basis of assets) by the amount excluded.

If a property was taken by the lender (foreclosure) or given up by the borrower (abandonment), the lender usually sends the taxpayer Form 1099-A, Acquisition or Abandonment of Secured Property. Form 1099-A will have information needed to determine the gain or loss due to the foreclosure or abandonment.

If the debt is canceled, the taxpayer will receive Form 1099-C, Cancellation of Debt. If foreclosure/abandonment and debt cancellation occur in the same calendar year, the lender may issue only Form 1099-C, including the information that would be reported on Form 1099-A.

The Mortgage Forgiveness Debt Relief Act of 2007 allows for the exclusion of discharged qualified principal residence indebtedness canceled in 2007, 2008, and 2009.

The Emergency Economic Stabilization Act of 2008 extended the exclusion for tax years 2010 through 2012. The American Taxpayer Relief Act of 2012 extended the exclusion to 12/31/2013.

The Tax Increase Prevention Act of 2014 extended the exclusion to 12/31/2014. The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) extended the exclusion through 2016.

Qualified Principal Residence Indebtedness

Qualified principal residence indebtedness includes:

- Any debt incurred in acquiring, constructing, or substantially improving a principal residence that is secured by the principal residence
- Any debt *secured by the principal residence resulting from the refinancing of debt* incurred to acquire, construct, or substantially improve a principal residence, but only to the extent that the amount of debt does not exceed the amount of the refinanced indebtedness

TIP

A principal residence is generally the home where the taxpayer lives most of the time. A taxpayer can have only one principal residence at a time.

Exclusion Limit

The maximum amount that can be treated as qualified principal residence indebtedness is $2 million ($1 million if Married Filing Separately).

Canceled qualified principal residence indebtedness cannot be excluded from income if the cancellation was for services performed for the lender or on account of any factor not directly related to a decline in the value of the residence or the taxpayer's financial condition.

Criteria for Canceled Principal Residence Debt

Volunteers may assist taxpayers who meet the following requirements:

- The home was never used in a business or as rental property
- The debt was not canceled because the taxpayer filed bankruptcy
- The taxpayer is **not** in bankruptcy when he/she comes to the site for assistance
- Form 1099-C does not include an amount for interest
- The debt must be a mortgage used *only* to buy, build, or substantially improve the taxpayer's primary residence, i.e., this money was not used to pay off credit cards, medical/dental expenses, vacations, etc.
- The mortgage was secured by the taxpayer's primary residence
- The mortgage was not more than $2 million ($1 million if Married Filing Separately)

example

Bob refinanced his personal residence and used the loan proceeds from the equity in his home to build a new master bedroom suite on the main level of his house. This debt is qualified principal residence indebtedness.

example

Tom refinanced his personal residence and used the loan proceeds from the equity in his home to pay off credit cards and buy a car. This debt is ***not*** qualified principal residence indebtedness.

EXERCISES

Use Publication 4731-A, Part II, to answer the following questions. The answers appear at the end of the lesson.

Question 1: A volunteer with Cancellation of Debt certification is working with Angie. Angie confirmed that she had to give up her principal residence and produced Form 1099-C for the cancellation of the mortgage loan. Angie explains that she did not file for bankruptcy, even though she experienced hardship due to the loss of income from no longer being able to rent out an upstairs bedroom and bath. Angie also verified that the mortgage loan was used entirely to purchase the home and was secured by the home. Her Form 1099-C lists the amount of debt canceled as $60,000.

Should the volunteer assist Angie with her return? ☐ Yes ☐ No

Question 2: Fred went to his local VITA site to have his tax return prepared. The volunteer went through Fred's records and noticed Form 1099-C reflecting a canceled debt of $50,000.

Using Publication 4731-A, Part II, as a guide, the volunteer learned Fred lost his job and could no longer make his mortgage payments. The bank foreclosed on Fred's home. Due to the housing market slump, the value of Fred's home had declined, and his mortgage balance was more than the fair market value of the home. The bank sold Fred's home and canceled the remaining debt ($50,000) not covered by the sale price.

Upon further questioning, the volunteer learned Fred had refinanced his home two years ago and used the equity in the home to pay off some credit cards and take a trip to Las Vegas.

Should the volunteer assist Fred with the preparation of his return at the VITA site? ☐ Yes ☐ No

Foreclosures and Capital Gain or Loss

If a taxpayer does not make payments owed 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 the taxpayer may realize a gain or loss. This is true even if the taxpayer voluntarily returns the property to the lender.

Figure the gain or loss from a foreclosure or repossession the same way as the gain or loss from a sale. The gain is the difference between the amount realized and the adjusted basis of the transferred property (amount realized minus adjusted basis). The loss is the difference between the adjusted basis in the transferred property and the amount realized (adjusted basis minus amount realized).

When a residence that is security for a mortgage is abandoned or foreclosed upon, the gain or loss must be reported on the return and is subject to the rules for a Sale of Residence.

Generally, the amount realized on a foreclosure is considered to be the selling price. But this selling price depends, in part, on whether the debt was recourse debt or nonrecourse debt. In addition, the taxpayer may also have ordinary income from the cancellation of debt.

Use the Worksheet for Foreclosures and Repossessions in Publication 4681 to figure the ordinary income from the cancellation of debt and the gain or loss from a foreclosure or repossession.

> CAUTION
> A loss on the sale or disposition of a personal residence is not deductible. A gain may qualify for the Section 121 exclusion ($250,000 or $500,000 for Married Filing Jointly taxpayers) for a gain on the sale of a personal residence.

Generally, the taxpayer's gain or loss from a foreclosure or abandonment is reported on Form 8949 and Schedule D.

If the taxpayer is personally liable for the debt (recourse debt), and the amount of outstanding debt (mortgage) is more than the home's FMV, the difference is treated as cancellation of debt income.

- If the canceled debt qualifies as excludable from gross income, the exclusion is reported on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (And Section 1082 Basis Adjustment)
- Otherwise, the canceled debt is reportable as ordinary income on Form 1040, line 21 and is beyond the scope of VITA/TCE

CAUTION

If the canceled debt is reportable on Form 1040, line 21 or the canceled debt is not fully excludable from gross income, the issue is beyond the scope of the VITA/TCE programs.

Form 1099-A, Acquisition or Abandonment of Secured Property

When a personal residence is foreclosed upon, and the lender cancels a portion of the debt, the taxpayer will generally receive Form 1099-A and Form 1099-C. If, in the same calendar year, the debt is canceled in connection with a foreclosure of secured property, the lender has the option of issuing Form 1099-C only.

TIP

For more information on determining the basis for sale of residence see the lesson on Income – Capital Gain or Loss, or Publication 17.

The filing requirements of Form 1099-A are met by the lender completing the following on Form 1099-C:

- Debt description
- The debtor was personally liable for the repayment of the debt
- Fair market value of property

Verify with the taxpayer that the information on Form 1099-A and Form 1099-C is correct. Pay particular attention to the amount of debt forgiven and the fair market value reported. Advise the taxpayer to contact the lender immediately if any of the information is not correct.

Form 1099-A, issued by the lender, reports the outstanding debt and the fair market value of the property. This form provides information needed to determine the amount of any gain or loss due to foreclosure or abandonment. Report the gain or loss from Form 1099-A on Form 8949 and Schedule D.

The sale price (amount realized) is based on whether the taxpayer is personally liable (recourse loan) or not personally liable (nonrecourse loan) for the debt.

- If the taxpayer is personally liable, the sale price is the **lesser** of the balance of the principal mortgage debt outstanding or the fair market value
- If the taxpayer is not personally liable, then the sale price is the full amount of the outstanding debt, as reflected on Form 1099-A
- For both recourse and nonrecourse loans, add any proceeds the taxpayer received from the foreclosure sale to the amount realized

Generally, if there is a loss on the sale of a principal residence or the entire gain is excluded under the Section 121 exclusion ($250,000 or $500,000 for Married Filing Jointly), the sale does not have to be reported. However, taxpayers who receive Form 1099-A should report the sale to account for the basis in the property.

CAUTION

Failure to report a foreclosure or abandonment transaction on Form 8949 and Schedule D may result in an IRS notice to the taxpayer.

Form 1099-C, Cancellation of Debt

Lenders or creditors are required to issue Form 1099-C if they cancel a debt owed to them of $600 or more. Generally, an individual taxpayer must include all canceled amounts (even if less than $600) on the "Other Income" line of Form 1040.

However, under certain circumstances, a taxpayer may not have to include canceled debt in income. For example, if the canceled debt is related to the taxpayer's principal residence, the taxpayer may be able to exclude all or a portion of canceled debt if it is "qualified principal residence indebtedness." The amount excluded due to the "discharge of qualified principal residence indebtedness" is reported on Form 982.

In addition to debtor information, Form 1099-C reports the amount of debt canceled and the date canceled. **If the form has event code "A" indicating bankruptcy, or if an amount is included for interest, refer the taxpayer to a professional tax preparer.**

Form 982 must be filed with the taxpayer's return to report the excluded amount of discharged indebtedness and the reduction of certain tax attributes. Taxpayers excluding discharged debt from "qualified principal residence indebtedness" must complete only a few lines on Form 982; check the discharge of qualified principal residence indebtedness box and include the amount of debt discharged from Form 1099-C to Form 982. If the taxpayer kept ownership of the home, the basis adjustment to the principal residence for the excluded canceled debt must be reflected on the form.

Coordination with Form 1099-A

As mentioned earlier, if a personal residence is foreclosed upon, and the debt is canceled in the same year, the taxpayer may receive Form 1099-C *only*. The required filing information from Form 1099-A will be shown on Form 1099-C.

Generally, the gross foreclosure bid price is considered to be the FMV. For an abandonment or voluntary conveyance in lieu of foreclosure, the FMV is generally the appraised value of the property.

For a recourse loan, the sale price is the **lesser** of the balance of the principal debt (mortgage) outstanding or fair market value.

Mortgage Workouts and Form 1099-C

Homeowners whose mortgage debt is partly forgiven through a loan modification, or "workout," which allows them to continue owning their residence, will receive Form 1099-C reporting the amount of debt discharged. Because the taxpayer kept ownership of the home, there is no gain or loss to be reported.

However, if the canceled debt meets the requirements of "qualified principal residence indebtedness," Form 982 must be completed to report the amount excluded from gross income and the reduction of tax attributes. See Publication 4012, Income tab, Capital Loss on Foreclosure, on how to complete Form 982.

Taxpayers who are not personally liable for the debt (nonrecourse debt) do not have ordinary income from the cancellation of the debt unless the lender:

- Offered a discount for the early payment of the debt or
- Agreed to a loan modification that resulted in the reduction of the principal balance of the debt

If a lender offers to discount (reduce) the principal balance of a loan that is paid off early, or agrees to a loan modification ("workout") that includes a reduction in the principal balance of a loan, the amount of the discount or the amount of the principal reduction is *canceled debt* whether or not the taxpayer is personally liable for the debt. The amount of the canceled debt must be included in income unless the exceptions or exclusions discussed earlier apply.

Gain or Loss Reported on Form 8949 and Schedule D

Form 8949, Sales and Other Dispositions of Capital Assets, includes all capital gain and loss transactions. The subtotals from Form 8949 are carried over to Schedule D, Capital Gains and Losses, where gain or loss is calculated in aggregate.

Losses on a personal residence are never deductible. Gains (all or part) may be excluded under the rules regarding the sale of a personal residence (Section 121 exclusion).

For more information on how to report the gain or losses, see the instructions for Form 8949.

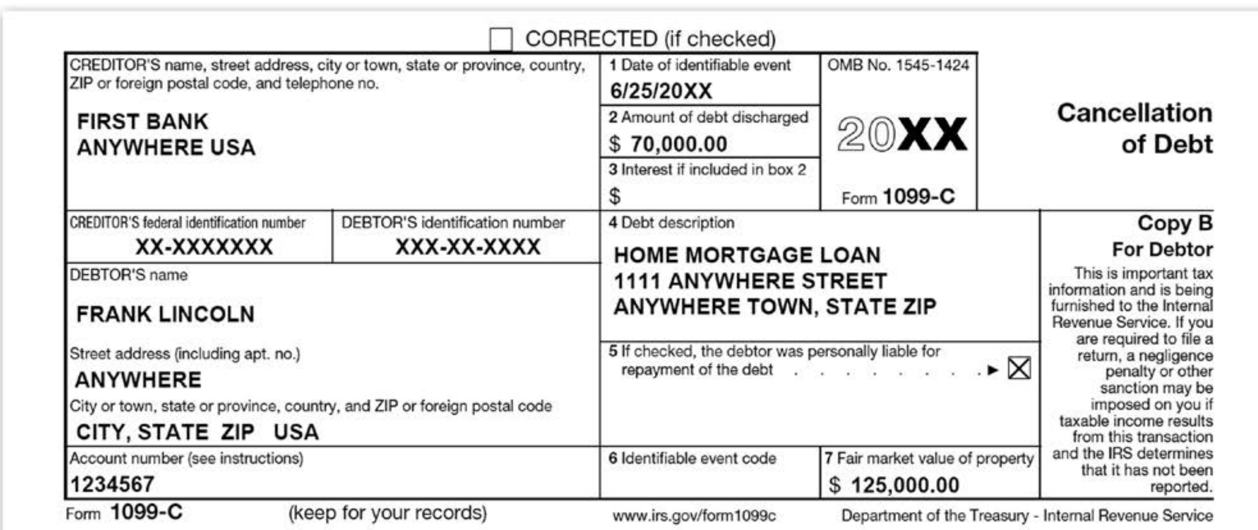
See Publication 4012, Legislative Extenders tab, Capital Loss on Foreclosure that shows how a foreclosure was reported on the Capital Gain or Loss Transaction Worksheet based on the information provided on Form 1099-A.

> **CAUTION**
> The following case studies are only examples of how the mentioned issues and forms can look and be reported. The dates and years of the forms are not relevant for these case studies.

Case Study – Reporting a Foreclosure and Canceled Debt

Frank bought his home on May 14, 2003. His basis in the home was $200,000. After he lost his job last year, he was not able to make the payments. The bank foreclosed in June of the current tax year, and Frank moved out. At the time of the foreclosure, the fair market value of the home was $125,000 and the principal balance of the mortgage was $195,000. All of the debt was incurred to purchase the home. Frank received Form 1099-C for the amount of debt canceled by his bank.

Frank has qualified principal residence indebtedness. His tax return should include Form 8949 and Schedule D to show the basis of the home disposed of through foreclosure, and Form 982 to exclude the debt cancellation from income.



☐ CORRECTED (if checked)

CREDITOR'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.
FIRST BANK
ANYWHERE USA

1 Date of identifiable event: 6/25/20XX
2 Amount of debt discharged: $ 70,000.00
3 Interest if included in box 2: $

OMB No. 1545-1424
20XX
Form 1099-C

Cancellation of Debt

CREDITOR'S federal identification number: XX-XXXXXXX
DEBTOR'S identification number: XXX-XX-XXXX

4 Debt description: HOME MORTGAGE LOAN, 1111 ANYWHERE STREET, ANYWHERE TOWN, STATE ZIP

DEBTOR'S name: FRANK LINCOLN

Street address (including apt. no.): ANYWHERE

City or town, state or province, country, and ZIP or foreign postal code: CITY, STATE ZIP USA

5 If checked, the debtor was personally liable for repayment of the debt . . . . ▸ ☒

Account number (see instructions): 1234567

6 Identifiable event code

7 Fair market value of property: $ 125,000.00

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.

Form 1099-C (keep for your records) www.irs.gov/form1099c Department of the Treasury - Internal Revenue Service

Form 8949 Attachment Sequence No. **12A** Page **2**

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

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either may show your basis (usually your cost) even if your broker did not report it to the IRS. Brokers must report basis to the IRS for most stock you bought in 2011 or later (and for certain debt instruments you bought in 2014 or later).

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are long term. For short-term transactions, see page 1.

Note. You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the total directly on Schedule D, line 8a; you are not required to report these transactions on Form 8949 (see instructions).

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

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

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss).** Subtract column (e) from column (d) and combine the result with column (g)
Main Home Form 1099-A	05/14/03	06/25/XX	$ 125,000	$ 200,000	L	$ 75,000	$ 0
2 Totals. Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8b** (if **Box D** above is checked), **line 9** (if **Box E** above is checked), or **line 10** (if **Box F** above is checked) ▶			$ 125,000	$ 200,000		$ 75,000	$ 0

Note. If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

Form **8949**

term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back 7

Part II **Long-Term Capital Gains and Losses—Assets Held More Than One Year**

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b .				
8b Totals for all transactions reported on Form(s) 8949 with **Box D** checked				
9 Totals for all transactions reported on Form(s) 8949 with **Box E** checked				
10 Totals for all transactions reported on Form(s) 8949 with **Box F** checked.	$125,000	$200,000	$75,000	$0
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824 11				
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 12				
13 Capital gain distributions. See the instructions 13				
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** in the instructions 14				( )
15 **Net long-term capital gain or (loss).** Combine lines 8a through 14 in column (h). Then go to Part III on the back 15				$0

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 11338H **Schedule D (Form 1040)**

Form **982**
(Rev. July 20XX)
Department of the Treasury
Internal Revenue Service

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

▶ Attach this form to your income tax return.
▶ Information about Form 982 and its instructions is at *www.irs.gov/form982*.

OMB No. 1545-0046
Attachment Sequence No. **94**

Name shown on return	Identifying number
FRANK LINCOLN	XXX-XX-XXXX

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	$70,000
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 ... in the reduction in

Case Study Alternative – Mortgage Workout

If Frank had been able to negotiate a workout with his mortgage lender (reducing the amount he owed on the mortgage and staying in the home), he would not have completed Form 8949 and Schedule D because he had not disposed of the asset.

Assume Frank's lender agreed to reduce his mortgage debt from $195,000 to $175,000. The lender issued Frank a Form 1099-C showing $20,000 of canceled debt. Frank's Form 982 would be completed, but the amount of debt forgiven (or his basis in the home, whichever was smaller) would need to be entered on the form, and his basis in the home would be decreased by that amount.

☐ CORRECTED (if checked)

CREDITOR'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. FIRST BANK ANYWHERE USA	1 Date of identifiable event 6/25/20XX 2 Amount of debt discharged $ 70,000.00 3 Interest if included in box 2 $	OMB No. 1545-1424 20**XX** Form **1099-C**	**Cancellation of Debt**
CREDITOR'S federal identification number XX-XXXXXXX	DEBTOR'S identification number XXX-XX-XXXX	4 Debt description HOME MORTGAGE LOAN 1111 ANYWHERE STREET ANYWHERE TOWN, STATE ZIP	**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 LINCOLN Street address (including apt. no.) ANYWHERE City or town, state or province, country, and ZIP or foreign postal code CITY, STATE ZIP USA		5 If checked, the debtor was personally liable for repayment of the debt ▶ ☒	
Account number (see instructions) 1234567		6 Identifiable event code	7 Fair market value of property $

Form **1099-C** (keep for your records) www.irs.gov/form1099c Department of the Treasury - Internal Revenue Service

Form **982** (Rev. July 20XX) Department of the Treasury Internal Revenue Service

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

▶ Attach this form to your income tax return.
▶ Information about Form 982 and its instructions is at *www.irs.gov/form982.*

OMB No. 1545-0046

Attachment Sequence No. **94**

Name shown on return	Identifying number
FRANK LINCOLN	XXX-XX-XXXX

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 $20,000
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:

		Line	Amount
4	For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4	
5	That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
6	Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6	
7	Applied to reduce any general business credit carryover to or from the tax year of the discharge	7	
8	Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8	
9	Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9	
10a	Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. *DO NOT use in the case of discharge of qualified farm indebtedness*	10a	
b	Applied to reduce the basis of your principal residence. *Enter amount here ONLY if line 1e is checked*	10b	$20,000
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		

EXERCISES (continued)

Question 3: A volunteer with Cancellation of Debt certification is working with Robert. The volunteer asks Robert if he underwent foreclosure or had to give up his home during the tax year. Robert confirmed that he did, and produced Form 1099-A. The volunteer asked Robert if he had received Form 1099-C, and Robert replied that he did not. Examining the form, the volunteer noted the balance of principal outstanding was $234,000. What should the volunteer do next?

A. Ask the questions on Publication 4731-A, Screening Sheet for Foreclosures/Abandonments and Cancellation of Debt

B. Ask enough probing questions to determine if Robert had a gain or loss on the foreclosure

C. Refer Robert to a professional tax preparer

D. Complete Form 982

EXERCISES (continued)

Question 4: Mary purchased her main home in June 2004 for $175,000. She lost her job and was no longer able to make her mortgage payments during the current year. In July of the current tax year, Mary moved out of the home to live with relatives. On July 15, the bank foreclosed on the home. On November 15, the bank discontinued its collection activity and canceled the remaining debt. The fair market value at the time of foreclosure was $100,000 because of the poor housing market, but Mary still owed $150,000 on the mortgage. None of the loan proceeds were used for any purpose other than to buy, build, or substantially improve the principal residence. Mary never used the home for business or rental purposes and has not filed for bankruptcy. Based on this information, what should the volunteer do?

A. Refer Mary to another source for tax return preparation

B. Report a loss of $50,000 on Schedule D

C. Report $50,000 debt canceled on Form 982

D. Include the debt cancellation amount in income

Question 5: After Tom became ill and could not work full time, he and his wife, Grace, were having difficulty making their mortgage payments. Rather than go through the expense of a foreclosure, the lender agreed to reduce the principal on their loan and refinance it with a better interest rate and lower payments. The principal balance before November 1 of the current tax year workout was $130,000, and the lender reduced the loan to $110,000. None of the loan proceeds were used for any purpose other than to buy, build, or substantially improve the principal residence. The home has never been used for business or as rental property, and the taxpayers have not filed for bankruptcy.

Based on this information, what should the volunteer do?

A. Refer Tom and Grace to another source for tax return preparation

B. Report the reduction in the basis of the home on line 10b of Form 982

C. Report the $20,000 as a loss on Schedule D

D. Include the debt cancellation amount in income

Question 6: Gene bought his home in 2003. His basis in the home was $210,000. He lost his job in January of the current tax year and was not able to make the mortgage payments. The bank foreclosed in August and Gene moved out. At the time of the foreclosure, the fair market value was $145,000 and the principal balance of the mortgage was $185,000. All of the debt was incurred to purchase the home, it was never used for business or as a rental property, and Gene has not filed for bankruptcy. Gene has a Form 1099-C. Gene is personally liable for repayment of the debt.

How should the foreclosure and loss be reported?

A. Report the $40,000 debt cancellation on Form 982, line 10b

B. Report the $40,000 debt cancellation on Form 982, line 2, only

C. Report the $40,000 debt cancellation on Form 982, line 2, and the foreclosure on Form 8949 and Schedule D

D. Report the $40,000 debt cancellation on Form 1040, line 21

Summary

Legislative extenders are temporary provisions. This content is being provided because they have been extended through the current tax year.

Tuition and Fees

Taxpayers can deduct up to $4,000 in qualified tuition and related expenses paid during the tax year as an adjustment to income.

Itemized Deductions

Taxpayers may be able to deduct qualified mortgage insurance premiums.

Nonbusiness Energy Property Credit

Taxpayers who make certain energy-efficient improvements to their main home may be eligible for this credit (Form 5695, Part II). The limit for this credit is $500 for all tax years.

Cancellation of Debt (COD)

A debt includes any indebtedness for which a taxpayer is liable or which attaches to the taxpayer's property. Cancellation of indebtedness can involve auto loans, credit card debt, medical care, professional services, installment purchases of furniture or other personal property, mortgages, and home equity loans.

Cancellation of debt can be complex. VITA/TCE volunteers may assist a taxpayer with issues related to cancellation of debt as long as the taxpayer meets all the criteria for discharge of qualified principal residence indebtedness or if all debt canceled and reported on Form 1099-C was nonbusiness credit card debt.

Taxpayers who go through a foreclosure or abandonment of their principal residence receive Form 1099-A, Acquisition or Abandonment of Secured Property. Form 1099-A will have information needed to determine the gain or loss due to the foreclosure or abandonment.

If the debt on the principal residence is canceled, the taxpayer will receive Form 1099-C, Cancellation of Debt. If foreclosure/abandonment and debt cancellation occur in the same calendar year, the lender may issue only Form 1099-C, including the information that would be reported on Form 1099-A.

Use Publication 4731-A, Screening Sheet for Foreclosures/Abandonments and Cancellation of Debt, which provides questions and step-by-step guidance to determine whether the cancellation of debt issue is within scope for the VITA/TCE programs.

- Use Publication 4731-A, Part I for taxpayers with Form 1099-A for a foreclosure or abandonment of their principal residence.
- Use Publication 4731-A, Part II for taxpayers with Form 1099-C, and/or Forms 1099-A and 1099-C resulting from cancellation of debt on a home mortgage loan.

What situations are out of scope for the VITA/TCE programs?

The following are out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Residential energy-efficient property credit (Form 5695, Part I)
- Cancellation of debt for issues other than "qualified principal residence indebtedness" or nonbusiness credit card debt
- Cancellation of debt for a principal residence that was used in a business or as rental property
- Cancellation of debt when Form 1099-C includes an amount for interest
- Cancellation of debt was because the taxpayer filed bankruptcy or was insolvent immediately before the debt was canceled

EXERCISE ANSWERS

Answer 1: *No. Because Angie used part of the home as rental property, all the canceled debt may not qualify to be excluded from income. The rules involving mortgage debt exclusions are complex. Angie should be referred to a professional tax preparer.*

Answer 2: *No. Fred's situation is outside the scope of the volunteer program since a portion of his refinanced debt was used for purposes other than to buy, build, or substantially improve his principal residence. Fred should be referred to a professional tax preparer, per the guidance on Publication 4731-A.*

Answer 3: *A. The volunteer should use Publication 4731-A, Part I to determine if Robert had a gain or loss on the foreclosure. If the taxpayer receives a Form 1099-C, the volunteer would use the screening sheet to determine if the related tax issues are within scope.*

Answer 4: *C. The volunteer would need to complete Form 8949, Schedule D, and Form 982. Although there is a loss, it cannot be deducted. The mortgage debt cancellation is not included in income on the tax return because it is covered by the qualified principal residence indebtedness exclusion on Form 982.*

Answer 5: *B. The volunteer would complete Form 982 and report the reduction in the basis of the home. The $20,000 in debt cancellation can be excluded as qualified principal residence indebtedness on Form 982 and is not counted as income on the tax return. Form 8949 and Schedule D are not required because Tom and Grace did not dispose of the home.*

Answer 6: *C. Form 982, Form 8949, and Schedule D should be completed. When a residence that is security for a mortgage is abandoned or foreclosed upon, it is treated as having been sold. This results in the foreclosure being reported on Form 8949 and Schedule D as sale of home. Failure to file Form 8949 and Schedule D may result in an IRS notice to the taxpayer.*

Notes