



## Mortgage Workouts, Now Tax-Free for Many Homeowners; Claim Relief on Newly-Revised IRS Form

Updated with FAQs at bottom — Feb. 28, 2008  
Updated with new link — Dec. 11, 2008

IR-2008-17, Feb. 12, 2008

WASHINGTON — Homeowners whose mortgage debt was partly or entirely forgiven during 2007 may be able to claim special tax relief by filling out newly-revised Form 982 and attaching it to their 2007 federal income tax return, according to the Internal Revenue Service.

Normally, debt forgiveness results in taxable income. But under the Mortgage Forgiveness Debt Relief Act of 2007, enacted Dec. 20, taxpayers may exclude debt forgiven on their principal residence if the balance of their loan was \$2 million or less. The limit is \$1 million for a married person filing a separate return. Details are on Form 982 and its instructions, available now on this Web site.

"The new law contains important provisions for struggling homeowners," said Acting IRS Commissioner Linda Stiff. "We urge people with mortgage problems to take full advantage of the valuable tax relief available."

The late-December enactment means that reporting procedures for this law change were not incorporated into tax-preparation software or IRS forms. For that reason, people using tax software should check with their provider for updates that include the revised Form 982. Similarly, the IRS is now updating its systems and expects to begin accepting electronically-filed returns that include Form 982 by March 3. The paper Form 982 is now being accepted, but the IRS reminds affected taxpayers to consider filing electronically, which greatly reduces errors and speeds refunds.

The new law applies to debt forgiven in 2007, 2008 or 2009. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, may qualify for this relief. In most cases, eligible homeowners only need to fill out a few lines on Form 982 (specifically, lines 1e, 2 and 10b).

The debt must have been used to buy, build or substantially improve the taxpayer's principal residence and must have been secured by that residence. Debt used to refinance qualifying debt is also eligible for the exclusion, but only up to the amount of the old mortgage principal, just before the refinancing.

Debt forgiven on second homes, rental property, business property, credit cards or car loans does not qualify for the new tax-relief provision. In some cases, however, other kinds of tax relief, based on insolvency, for example, may be available. See Form 982 for details.

Borrowers whose debt is reduced or eliminated receive a year-end statement (Form 1099-C) from their lender. For debt cancelled in 2007, the lender was required to provide this form to the borrower by Jan. 31, 2008. By law, this form must show the amount of debt forgiven and the fair market value of any property given up through foreclosure.

The IRS urges borrowers to check the Form 1099-C carefully. Notify the lender immediately if any of the information shown is incorrect. Borrowers should pay particular attention to the amount of debt forgiven (Box 2) and the value listed for their home (Box 7).

**Note:** Legislation enacted in October 2008 extended this relief through 2012. Thus this relief now applies to debt forgiven in calendar years 2007 through 2012.

### Related Items:

- Frequently asked questions on the [Mortgage Forgiveness Debt Relief Act](#)
- [Form 982](#), Reduction of Tax Attributes Due to Discharge of Indebtedness
- [1099-C](#)
- [Publication 4681](#), Canceled Debts, Foreclosures, Repossessions, and Abandonments

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Page Last Reviewed or Updated: February 24, 2009



## Home Foreclosure and Debt Cancellation

*Update Dec. 11, 2008 — The Mortgage Forgiveness Debt Relief Act of 2007 generally allows taxpayers to exclude income from the discharge of debt on their principal residence. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualify for this relief.*

*This provision applies to debt forgiven in calendar years 2007 through 2012. Up to \$2 million of forgiven debt is eligible for this exclusion (\$1 million if married filing separately). The exclusion doesn't apply if the discharge is due to services performed for the lender or any other reason not directly related to a decline in the home's value or the taxpayer's financial condition.*

*The amount excluded reduces the taxpayer's cost basis in the home. More [details](#). Further information, including detailed examples, can also be found in [Publication 4681](#), Canceled Debts, Foreclosures, Repossessions, and Abandonments.*

*The questions and answers, below, are based on the law prior to the passage of the Mortgage Forgiveness Debt Relief Act of 2007.*

### 1. What is Cancellation of Debt?

If you borrow money from a commercial lender and the lender later cancels or forgives the debt, you may have to include the cancelled amount in income for tax purposes, depending on the circumstances. When you borrowed the money you were not required to include the loan proceeds in income because you had an obligation to repay the lender. When that obligation is subsequently forgiven, the amount you received as loan proceeds is reportable as income because you no longer have an obligation to repay the lender. **The lender is usually required to report the amount of the canceled debt to you and the IRS on a Form 1099-C, Cancellation of Debt.**

Here's a very simplified example. You borrow \$10,000 and default on the loan after paying back \$2,000. If the lender is unable to collect the remaining debt from you, there is a cancellation of debt of \$8,000, which generally is taxable income to you.

### 2. Is Cancellation of Debt income always taxable?

Not always. There are some exceptions. The most common situations when cancellation of debt income is not taxable involve:

- **Bankruptcy:** Debts discharged through bankruptcy are not considered taxable income.
- **Insolvency:** If you are insolvent when the debt is cancelled, some or all of the cancelled debt may not be taxable to you. **You are insolvent when your total debts are more than the fair market value of your total assets.** Insolvency can be fairly complex to determine and the assistance of a tax professional is recommended if you believe you qualify for this exception.
- **Certain farm debts:** If you incurred the debt directly in operation of a farm, more than half your income from the prior three years was from farming, and the loan was owed to a person or agency regularly engaged in lending, your cancelled debt is generally not considered taxable income. The rules applicable to farmers are complex and the assistance of a tax professional is recommended if you believe you qualify for this exception.
- **Non-recourse loans:** A non-recourse loan is a loan for which the lender's only remedy in case of default is to repossess the property being financed or used as collateral. That is, the lender cannot pursue you personally in case of default. Forgiveness of a non-recourse loan resulting from a foreclosure does not result in cancellation of debt income. However, it may result in other tax consequences, as discussed in Question 3 below.

### 3. I lost my home through foreclosure. Are there tax consequences?

There are two possible consequences you must consider:

- Taxable cancellation of debt income. **(Note: As stated above, cancellation of debt income is not taxable in the case of non-recourse loans.)**
- A reportable gain from the disposition of the home (because foreclosures are treated like sales for tax purposes). (Note: Often some or all of the gain from the sale of a personal residence qualifies for exclusion from income.)

Use the following steps to compute the income to be reported from a foreclosure:

**Step 1 - Figuring Cancellation of Debt Income** *(Note: For non-recourse loans, skip this section. You have no income from cancellation of debt.)*

1. Enter the total amount of the debt immediately prior to the foreclosure. \_\_\_\_\_
2. Enter the fair market value of the property from Form 1099-C, box 7. \_\_\_\_\_
3. Subtract line 2 from line 1. If less than zero, enter zero. \_\_\_\_\_

The amount on line 3 will generally equal the amount shown in box 2 of Form 1099-C. This amount is taxable unless you meet one of the exceptions in question 2. Enter it on line 21, Other Income, of your Form 1040.

#### Step 2 - Figuring Gain from Foreclosure

4. Enter the fair market value of the property foreclosed. For non-recourse loans, enter the amount of the debt immediately prior to the foreclosure. \_\_\_\_\_
5. Enter your adjusted basis in the property. (Usually your purchase price plus the cost of any major improvements.) \_\_\_\_\_
6. Subtract line 5 from line 4. If less than zero, enter zero. \_\_\_\_\_

The amount on line 6 is your gain from the foreclosure of your home. If you have owned and used the home as your

principal residence for periods totaling at least two years during the five year period ending on the date of the foreclosure, you may exclude up to \$250,000 (up to \$500,000 for married couples filing a joint return) from income. If you do not qualify for this exclusion, or your gain exceeds \$250,000 (\$500,000 for married couples filing a joint return), report the taxable amount on Schedule D, Capital Gains and Losses.

#### 4. I lost money on the foreclosure of my home. Can I claim a loss on my tax return?

No. Losses from the sale or foreclosure of personal property are not deductible.

#### 5. Can you provide examples?

A borrower bought a home in August 2005 and lived in it until it was taken through foreclosure in September 2007. The original purchase price was \$170,000, the home is worth \$200,000 at foreclosure, and the mortgage debt canceled at foreclosure is \$220,000. At the time of the foreclosure, the borrower is insolvent, with liabilities (mortgage, credit cards, car loans and other debts) totaling \$250,000 and assets totaling \$230,000.

The borrower figures income from the foreclosure as follows:

Use the following steps to compute the income to be reported from a foreclosure:

**Step 1 - Figuring Cancellation of Debt Income** (*Note: For non-recourse loans, skip this section. You have no income from cancellation of debt.*)

1. Enter the total amount of the debt immediately prior to the foreclosure. \$220,000
2. Enter the fair market value of the property from Form 1099-C, box 7. \$200,000
3. Subtract line 2 from line 1. If less than zero, enter zero. \$20,000

The amount on line 3 will generally equal the amount shown in box 2 of Form 1099-C. This amount is taxable unless you meet one of the exceptions in question 2. Enter it on line 21, Other Income, of your Form 1040.

#### Step 2 - Figuring Gain from Foreclosure

4. Enter the fair market value of the property foreclosed. For non-recourse loans, enter the amount of the debt immediately prior to the foreclosure. \$200,000
5. Enter your adjusted basis in the property. (Usually your purchase price plus the cost of any major improvements.) \$170,000
6. Subtract line 5 from line 4. If less than zero, enter zero. \$30,000

The amount on line 6 is your gain from the foreclosure of your home. If you have owned and used the home as your principal residence for periods totaling at least two years during the five year period ending on the date of the foreclosure, you may exclude up to \$250,000 (up to \$500,000 for married couples filing a joint return) from income. If you do not qualify for this exclusion, or your gain exceeds \$250,000 (\$500,000 for married couples filing a joint return), report the taxable amount on Schedule D, Capital Gains and Losses.

In this situation, the borrower has a tax-free home-sale gain of \$30,000 (\$200,000 minus \$170,000), because they owned and lived in their home as a principal residence for at least two years. Ordinarily, the borrower would also have taxable debt-forgiveness income of \$20,000 (\$220,000 minus \$200,000). But since the borrower's liabilities exceed assets by \$20,000 (\$250,000 minus \$230,000) there is no tax on the canceled debt.

Other examples can be found in IRS Publication 544, Sales and Other Dispositions of Assets, under the section "Foreclosures and Repossessions".

#### 6. I don't agree with the information on the Form 1099-C. What should I do?

Contact the lender. The lender should issue a corrected form if the information is determined to be incorrect. Retain all records related to the purchase of your home and all related debt.

#### 7. I received a notice from the IRS on this. What should I do?

The IRS urges borrowers with questions to call the phone number shown on the notice. The IRS also urges borrowers who wind up owing additional tax and are unable to pay it in full to use the installment agreement form, normally included with the notice, to request a payment agreement with the agency.

#### 8. Where else can I go to get tax help?

If you are having difficulty resolving a tax problem (such as one involving an IRS bill, letter or notice) through normal IRS channels, the [Taxpayer Advocate Service](#) may be able to help. For more information, you can also call the TAS toll-free case intake line at 1-877-777-4778, TTY/TDD 1-800-829-4059.

In some cases, you may qualify for free or low-cost assistance from a Low Income Taxpayer Clinic (LITC). LITCs are independent organizations that represent low income taxpayers in tax disputes with the IRS. Find [information](#) on an LITCs in your area.

#### Related Items:

- [Publication 523](#), Selling Your Home
- [Publication 544](#), Sales and Other Dispositions of Assets
- [Publication 908](#), Bankruptcy Tax Guide

- [Form 1040](#), U.S. Individual Income Tax Return
- [Form 1040, Schedule D](#), Capital Gains and Losses
- [Form 1099-C](#), Cancellation of Debt
- [Form 9465](#), Installment Agreement Request

*Page Last Reviewed or Updated: December 11, 2008*

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

OMB No. 1545-0046

Attachment  
Sequence No. **94**▶ **Attach this form to your income tax return.**

Name shown on return

Identifying number

**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 ☐
- f** Discharge of certain indebtedness of a qualified individual because of Midwestern disasters ☐

- 2** Total amount of discharged indebtedness excluded from gross income. **2**
- 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:**

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

**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.

## General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

### What's New

- The Emergency Economic Stabilization Act of 2008 extended the exclusion from gross income for the discharge of qualified principal residence indebtedness by an additional 3 years. This exclusion now applies to debt discharged after 2006 and before 2013.
- The Heartland Disaster Tax Relief Act of 2008 allows qualified individuals to exclude from gross income discharges of certain indebtedness because of Midwestern disasters. See the instructions for line 1f for more information.
- The American Recovery and Reinvestment Act of 2009 allows certain businesses to elect to defer and include ratably over five tax years any income from the discharge of business


debt arising from the reacquisition of certain types of business debt repurchased in 2009 and 2010. If you make this election, you cannot exclude for the taxable year of the election or any subsequent taxable year the income from the discharge of such indebtedness based on a title 11 bankruptcy case, insolvency, qualified farm indebtedness, or qualified real property business indebtedness. For more details, including how to make the election, see section 108(i).

### Purpose of Form

Generally, the amount by which you benefit from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in section 108, you can exclude the amount of discharged indebtedness from your gross income.

You must file Form 982 to report the exclusion and the reduction of certain tax attributes either dollar for dollar or 33⅓ cents per dollar (as explained below).

## How To Complete the Form

IF the discharged debt you are excluding is . . .	THEN follow these steps . . .
Qualified principal residence indebtedness	<ol style="list-style-type: none"> <li>1. Be sure to read the definition of qualified principal residence indebtedness in the instructions for line 1e on page 4. Part or all of your debt may not qualify for the exclusion on line 1e but may qualify for one of the other exclusions.</li> <li>2. Check the box on line 1e.</li> <li>3. Include on line 2 the amount of discharged qualified principal residence indebtedness that is excluded from gross income. Any amount in excess of the excluded amount may result in taxable income. See Pub. 4681, for more information. If you disposed of your residence, you may also be required to recognize a gain on its disposition. For details, see Pub. 523, Selling Your Home.</li> <li>4. If you continue to own your residence after the discharge, enter on line 10b the smaller of (a) the amount of qualified principal residence indebtedness included on line 2 or (b) the basis (generally, your cost plus improvements) of your principal residence.</li> </ol> <div data-bbox="423 1045 526 1146">  <p><b>CAUTION</b></p> </div> <p><i>If the discharge occurs in a title 11 case, you cannot check box 1e. You must check box 1a and complete the form as discussed below under A nonbusiness debt. If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of box 1e and completing the form as discussed below under A nonbusiness debt.</i></p>
A nonbusiness debt (other than qualified principal residence indebtedness, such as a car loan or credit card debt)	<p>Follow these instructions if you do not have any of the tax attributes listed in Part II (other than a basis in nondepreciable property). Otherwise, follow the instructions for <i>Any other debt</i> below.</p> <ol style="list-style-type: none"> <li>1. Check the box on line 1a if the discharge was made in a <i>title 11 case</i> (see the definition in the instructions on page 3), the box on line 1b if the discharge occurred when you were <i>insolvent</i> (see the definition in the instructions for line 1b on page 3), or the box on line 1f if you are a <i>qualified individual</i> whose indebtedness was discharged by an <i>applicable entity</i> because of a Midwestern disaster (see the definitions in the instructions for line 1f on page 4).</li> <li>2. Include on line 2 the amount of discharged nonbusiness debt that is excluded from gross income. If you were insolvent, do not include more than the excess of your liabilities over the fair market value of your assets.</li> <li>3. Include on line 10a the smallest of (a) the basis of your nondepreciable property, (b) the amount of the nonbusiness debt included on line 2, or (c) the excess of the aggregate bases of the property and the amount of money you held immediately after the discharge over your aggregate liabilities immediately after the discharge.</li> </ol>
Any other debt	<p>Use <i>Part I</i> of Form 982 to indicate why any amount received from the discharge of indebtedness should be excluded from gross income and the amount excluded.</p> <p>Use <i>Part II</i> to report your reduction of tax attributes. The reduction must be made in the following order unless you check the box on line 1d for qualified real property business indebtedness or make the election on line 5 to reduce basis of depreciable property first.</p> <ol style="list-style-type: none"> <li>1. Any net operating loss (NOL) for the tax year of the discharge (and any NOL carryover to that year) (dollar for dollar);</li> <li>2. Any general business credit carryover to or from the tax year of the discharge (33⅓ cents per dollar);</li> <li>3. Any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge (33⅓ cents per dollar);</li> <li>4. Any net capital loss for the tax year of the discharge (and any capital loss carryover to that tax year) (dollar for dollar);</li> <li>5. The basis of property (dollar for dollar);</li> <li>6. Any passive activity loss (dollar for dollar) and credit (33⅓ cents per dollar) carryovers from the tax year of the discharge; and</li> <li>7. Any foreign tax credit carryover to or from the tax year of the discharge (33⅓ cents per dollar).</li> </ol> <p>Use <i>Part III</i> to exclude from gross income under section 1081(b) any amounts of income attributable to the transfer of property described in that section.</p>





*Certain individuals may need to complete only a few lines on Form 982. For example, if you are completing this form because of a discharge of indebtedness on a personal loan (such as a car loan or credit card debt) or a loan for the purchase of your principal residence, follow the chart on page 2 to see which lines you need to complete. Also, see Pub. 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments, for additional information including many examples and completed forms.*

## Definitions

### Title 11 Case

A *title 11 case* is a case under title 11 of the United States Code (relating to bankruptcy), but only if you are under the jurisdiction of the court in the case and the discharge of indebtedness is granted by the court or is under a plan approved by the court.

### Discharge of Indebtedness

The term *discharge of indebtedness* conveys forgiveness of, or release from, an obligation to repay.

### When To File

File Form 982 with your federal income tax return for a year a discharge of indebtedness is excluded from your income under section 108(a).

The election to reduce the basis of depreciable property under section 108(b)(5) and the election made on line 1d of Part I regarding the discharge of qualified real property business indebtedness must be made on a timely-filed return (including extensions) and can be revoked only with the consent of the IRS.

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

## Specific Instructions

### Part I



*If you made an election under section 108(i) to defer income from the discharge of business debt arising from the reacquisition of a debt instrument, you cannot exclude on lines 1a through 1d the income from the discharge of such indebtedness for the taxable year of the election or any subsequent taxable year.*

### Line 1b

The insolvency exclusion does not apply to any discharge that occurs in a title 11 case. It also does not apply to a discharge of qualified principal residence indebtedness (see the instructions for line 1e on page 4) unless you elect to have the insolvency exclusion apply instead of the exclusion for qualified principal residence indebtedness.

Check the box on line 1b if the discharge of indebtedness occurred while you were insolvent. You were insolvent to the extent that your liabilities exceeded the fair market value (FMV) of your assets immediately before the discharge. For details and a worksheet to help calculate insolvency, see Pub. 4681.

**Example.** You were released from your obligation to pay your credit card debt in the amount of \$5,000. The FMV of your total assets immediately before the discharge was \$7,000 and your liabilities were \$10,000. You were insolvent to the extent of \$3,000 (\$10,000 of total liabilities minus \$7,000 of total assets). Check the box on line 1b and include \$3,000 on line 2.

### Line 1c

Check this box if the income you exclude is from the discharge of qualified farm indebtedness. The exclusion relating to qualified farm indebtedness does not apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

*Qualified farm indebtedness* is the amount of indebtedness incurred directly in connection with the trade or business of farming. In addition, 50% or more of your aggregate gross receipts for the 3 tax years preceding the tax year in which the discharge of such indebtedness occurs must be from the trade or business of farming. For more information, see sections 108(g) and 1017(b)(4).

The discharge must have been made by a qualified person. Generally, a *qualified person* is an individual, organization, etc., who is actively and regularly engaged in the business of lending money. This person cannot be related to you, be the person from whom you acquired the property, or be a person who receives a fee with respect to your investment in the property. Also, a qualified person includes any federal, state, or local government or agency or instrumentality thereof.

If you checked line 1c and did not make the election on line 5, the debt discharge amount will be applied to reduce the tax attributes in the order listed on lines 6 through 9. Any remaining amount will be applied to reduce the tax attributes in the order listed on lines 11a through 13.

You cannot exclude more than the total of your: (a) tax attributes (determined under section 108(g)(3)(B)); and (b) basis of property used or held for use in a trade or business or for the production of income. Any excess is included in income.

### Line 1d

If you check this box, the discharge of qualified real property business indebtedness is applied to reduce the basis of depreciable real property on line 4. The exclusion relating to qualified real property business indebtedness does not apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

*Qualified real property business indebtedness* is indebtedness (other than qualified farm indebtedness) that: (a) is incurred or assumed in connection with real property used in a trade or business; (b) is secured by that real property; and (c) with respect to which you have made an election under this provision. This provision does not apply to a corporation (other than an S corporation).

Indebtedness incurred or assumed after 1992 is not qualified real property business indebtedness unless it is either: (a) debt incurred to refinance qualified real property business indebtedness incurred or assumed before 1993 (but only to the extent the amount of such debt does not exceed the amount of debt being refinanced) or (b) qualified acquisition indebtedness.

*Qualified acquisition indebtedness* is (a) debt incurred or assumed to acquire, construct, reconstruct, or substantially improve real property that is secured by such debt; and (b) debt resulting from the refinancing of qualified acquisition indebtedness, to the extent the amount of such debt does not exceed the amount of debt being refinanced.

You cannot exclude more than the excess of the outstanding principal amount of the debt (immediately before the discharge) over the net FMV (as of that time) of the property securing the debt, reduced by the outstanding principal amount of other qualified real property business indebtedness secured by that property (as of that time). The amount excluded is further limited to the aggregate adjusted basis (as of the first day of the next tax year, or if earlier, the date of disposition) of depreciable real property (determined

after any reductions under sections 108(b) and (g)) you held immediately before the discharge (other than property acquired in contemplation of the discharge). Any excess is included in income.

### Line 1e

Check this box if the income you exclude is from discharge of qualified principal residence indebtedness. Also, be sure you complete line 2 (and line 10b if you continue to own the residence after discharge). However, if the discharge occurs in a title 11 case, you must check the box on line 1a and not this box. If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of checking this box. For more information, see Pub. 4681.

**Principal residence.** Your *principal residence* is the home where you ordinarily live most of the time. You can have only one principal residence at any one time.

**Qualified principal residence indebtedness.** This indebtedness is a mortgage you took out to buy, build, or substantially improve your principal residence. It also must be secured by your principal residence. If the amount of your original mortgage is more than the cost of your principal residence plus the cost of any substantial improvements, only the debt that is **not** more than the cost of your principal residence plus improvements is qualified principal residence indebtedness. Any debt secured by your principal residence that you use to refinance qualified principal residence indebtedness is treated as qualified principal residence indebtedness, but only up to the amount of the old mortgage principal just before the refinancing. Any additional debt you incurred to substantially improve your principal residence is also treated as qualified principal residence indebtedness.

**Amount eligible for the exclusion.** The exclusion applies only to debt discharged after 2006 and before 2013. The maximum amount you can treat as qualified principal residence indebtedness is \$2 million (\$1 million if married filing separately). You cannot exclude from gross income discharge of qualified principal residence indebtedness if the discharge 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 residence 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 discharged exceeds the amount of the loan (immediately before the discharge) that is **not** qualified principal residence indebtedness. For example, assume your principal residence is secured by a debt of \$1 million, of which \$800,000 is qualified principal residence indebtedness. If your residence is sold for \$700,000 and \$300,000 of debt is discharged, only \$100,000 of the debt discharged can be excluded (the \$300,000 that was discharged minus the \$200,000 of nonqualified debt). The remaining \$200,000 of nonqualified debt may qualify in whole or in part for one of the other exclusions, such as the insolvency exclusion.

### Line 1f

Check this box, if the income you exclude is nonbusiness debt that is discharged by an *applicable entity* and you are a *qualified individual*. This exclusion only applies to discharges made on or after the *applicable disaster date* and before 2010, and does not apply to any indebtedness secured by real property located outside of the Midwestern disaster area. Any amount excluded from gross income must be used to reduce certain tax attributes as explained earlier under *How To Complete the Form*.

**Qualified individual.** To be a qualified individual, you must be an individual whose principal residence on the applicable disaster date, was located in:

- The Midwestern disaster area as listed in Table 1 of Pub. 4492-B, Information for Affected Taxpayers in the Midwestern Disaster Areas, or
- The area listed in Table 2 of Pub. 4492-B and you suffered an economic loss because of a Midwestern disaster.

**Applicable entity.** An applicable entity includes:

- A financial institution described in section 581 or 591(a) (such as a domestic bank, trust company, building and loan or savings and loan association).
- A credit union.
- A federal government agency including a department, an agency, a court or court administrative office, or an instrumentality in the executive, judicial, or legislative branch of the government, including government corporations.
- Any of the following, its successor, or subunit of one of the following:
  - a. Federal Deposit Insurance Corporation,
  - b. Resolution Trust Corporation,
  - c. National Credit Union Administration,
  - d. Any military department,
  - e. U.S. Postal Service, or
  - f. Postal Rate Commission.
- Certain subsidiaries of a financial institution or credit union.
- Any organization whose significant trade or business is the lending of money, such as a finance company or credit card company (whether or not affiliated with a financial institution).



*An entity that is required to file Form 1099-C, Cancellation of Debt, is an applicable entity.*

**Applicable disaster date.** This is the date on which the severe storms, tornadoes, or flooding occurred in the Midwestern disaster areas.

**Midwestern disaster areas.** A Midwestern disaster area is an area for which a major disaster was declared by the President during the period beginning on May 20, 2008, and ending on July 31, 2008, in the state of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, or Wisconsin as a result of severe storms, tornadoes or flooding that occurred on the applicable disaster date. See Tables 1 and 2 in Pub. 4492-B for a list of the counties included in the Midwestern disaster areas.

### Line 2

Enter the total amount excluded from your gross income due to discharge of indebtedness under section 108. If you checked any box on lines 1b through 1e, do not enter more than the limit explained in the instructions for those lines. If you checked line 1a, 1b, 1c, or 1f, this amount will not necessarily equal the total reductions on lines 5 through 13 (excluding line 10b) because the debt discharge amount may exceed the total tax attributes. If you checked line 1e, this amount will not necessarily equal the total basis reduction on line 10b (which is required only if you continue to own the residence after the discharge).

See section 382(l)(5) for a special rule regarding a reduction of a corporation's tax attributes after certain ownership changes.

### Line 3

You can elect under section 1017(b)(3)(E) to treat all real property held primarily for sale to customers in the ordinary course of a trade or business as if it were depreciable property. This election does not apply to the discharge of qualified real property business indebtedness. To make the election, check the "Yes" box.



## Part II

### Basis Reduction

If you check any of the boxes on lines 1a through 1c and 1f, you can elect, by completing line 5, to apply all or a part of the debt discharge amount to first reduce the basis of depreciable property (including property you elected on line 3 to treat as depreciable property). Any balance of the debt discharge amount will then be applied to reduce the tax attributes in the order listed on lines 6 through 13 (excluding line 10b). You must attach a statement describing the transactions that resulted in the reduction in basis under section 1017 and identifying the property for which you reduced the basis. If you do not make the election on line 5, complete lines 6 through 13 (excluding line 10b) to reduce your attributes. See section 1017(b)(2) and (c) for limitations of reductions in basis on line 10a.

#### Line 7

If you have a general business credit carryover to or from the tax year of the discharge, you must reduce that carryover by 33⅓ cents for each dollar excluded from gross income. See Form 3800, General Business Credit, for more details on the general business credit, including rules for figuring any carryforward or carryback.

#### Line 10a

In the case of a title 11 case or insolvency (except when an election under section 108(b)(5) is made), the reduction in basis is limited to the aggregate of the basis of your property immediately after the discharge over the aggregate of your liabilities immediately after the discharge.

#### Line 10b

If box 1e is checked and you continue to own the residence after discharge, enter the smaller of:

- The part of line 2 that is attributable to the exclusion of qualified principal residence indebtedness, or
- The basis of your principal residence.

## Part III

### Adjustment to Basis

Unless it specifically states otherwise, the corporation, by filing this form, agrees to apply the general rule for adjusting the basis of property (as described in Regulations section 1.1082-3(b)).

If the corporation desires to have the basis of its property adjusted in a manner different from the general rule, it must attach a request for variation from the general rule. The request must show the precise method used and the allocation of amounts.

Consent to the request for variation from the general rule will be effective only if it is incorporated in a closing agreement entered into by the corporation and the Commissioner of Internal Revenue under the rules of section 7121. If no agreement is entered into, then the general rule will apply in determining the basis of the corporation's property.

**Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown as follows:

**Recordkeeping**, 5 hr., 58 min.; **Learning about the law or the form**, 2 hr., 17 min.; **Preparing and sending the form to the IRS**, 2 hr., 28 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.