Publication 4491

VITA/TCE **Training Guide**

Volunteer Income Tax Assistance (VITA) / Tax Counseling for the Elderly (TCE)

Volume 2 of 16

2023 RETURNS

Take your VITA/TCE training online at: **apps.irs.gov/app/vita/** (keyword: Link & Learn Taxes). Link to the Practice Lab to gain experience using tax software and take the certification test online, with immediate scoring and feedback.

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What is due diligence?

Due diligence means doing your part to ensure tax returns are correct. As an IRS-certified volunteer, you ensure the information on the return you are preparing or reviewing is correct and complete.

Doing your part includes:

- Confirming a taxpayer’s (and spouse’s, if married filing jointly) identity
- Providing top-quality service by helping them understand and meet their tax responsibilities
- Clarifying information that may appear to be inconsistent or incomplete

Generally, IRS-certified volunteers may rely in good faith on information from a taxpayer without requiring documentation as verification. However, part of due diligence requires volunteers to ask a taxpayer to clarify information that may appear to be inconsistent or incomplete. When reviewing information for its accuracy, volunteers need to ask themselves if the information is unusual or questionable. If at any time a volunteer becomes uncomfortable with the information provided by the taxpayer, the volunteer should not prepare the tax return.

Top 4 Things to Remember about Due Diligence

1. Do your part to ensure a tax return is correct.
2. Question any unusual, inconsistent, or incomplete items.
3. If you are unsure about a deduction or credit, make an effort to research the answer, or ask another certified volunteer for assistance.
4. Remind taxpayers that when they sign their tax returns, they are stating under penalty of perjury that the

return is accurate to the best of their knowledge.

The following examples illustrate unusual or questionable situations that call for more information from the taxpayer.

Larry goes to a VITA/TCE site to have his taxes prepared. Larry tells the tax preparer:

- *His filing status is Head of Household*
- *He wants to claim his 2-year-old nephew for EIC*
- *He has no child care expenses*
- *He earned $19,000 in wages*
- *He is 26 years old*

Larry's information regarding his qualifying child and filing status is questionable. Further inquiries are needed to determine:

- *Why the uncle is claiming the child and not the parents?*
- *Why isn't there child care expense and who cares for the child while the taxpayer works?*
- *Is there anyone else living in the household that contributes?*
- *Is there anyone else eligible to claim the child?*
- *Do the tie-breaker rules apply?*
- *If asked, can the taxpayer provide proof that the qualifying child lived with him for more than half of the year?*

Steven goes to a VITA/TCE site to have his taxes prepared. Steven tells the tax preparer:

- *He is 22 years old*
- *He has two sons, ages 10 and 11*

- *He has Social Security cards for both boys and himself*
- *His W-2 wage indicates earnings of $20,000*

Steven's age and the age of the qualifying children appear to be inconsistent. Further inquiries are needed to determine:

- *Are the boys his sons by birth, foster sons, adopted sons, step-sons?*
- *Is there anyone else eligible to claim the children as qualifying children?*
- *Do the tie-breaker rules apply?*
- *If asked, can the taxpayer provide proof that the qualifying children lived with him for more than half of the year?*

As a certified volunteer, remember due diligence and take reasonable steps to ensure the tax return is correct:

- Ask enough questions to determine if allowable expenses were incurred and that income reported is correct.
- Add all taxable income to the tax return.
- If the item is questionable and/or unallowable, do not claim the deduction or credit on the tax return. Make a note on Form 13614-C, Intake/Interview and Quality Review Sheet to alert the reviewer (Form 13614-NR for Foreign Student and Scholar program).
- If you are uncomfortable with the information and/or documentation provided by a taxpayer, do not prepare the tax return.
- If the taxpayer wishes to take a position on their return that is contrary to your training, you should not prepare the return.

Tax return integrity means volunteers must take reasonable steps to ensure the tax return is correct, which includes:

- Verifying that all Social Security numbers presented by the taxpayer match the Social Security numbers listed on the tax return.
- Not preparing out of scope returns.
- Not preparing returns for which you have not been certified.
- Explaining to the taxpayer what income is taxable and why a deduction or credit can or cannot be included on their return. Use IRS reference materials to support your statements.
- Having a second certified volunteer quality review the completed return and discuss it with the taxpayer.

- Not making changes or corrections to the tax return after the taxpayer leaves the site without notifying the taxpayer.

In conclusion, as an IRS-certified volunteer preparer, you have the responsibility to perform adequate due diligence on EVERY return. The goal is not to prepare as many tax returns as possible, but to accurately report taxpayer income and deductions.

How do I maintain the taxpayer's trust?

You are the key to the integrity of the VITA/TCE programs. Taxpayers will trust that all information you receive from them is protected from disclosure. To maintain this trust:

- Do not disclose any personal tax information gained as a result of the service provided.

- Do not openly discuss taxpayers by name in the presence of other volunteers or taxpayers. You may discuss tax situations with other volunteers. For example, a volunteer may refer to a *situation* (not a taxpayer) and ask for or give advice about the appropriate tax treatment for that specific situation.
- Do not retain taxpayers' documents for a follow-up visit. If you cannot fully complete the taxpayer's return at the time of service, return all documents to the taxpayer.
- Do not take taxpayers' information for preparation of the return outside the presence of the taxpayer, unless Virtual VITA/TCE procedures are being used.
- Do not prepare a tax return when you suspect an individual is not providing truthful information.

- Do not exclude any of the taxpayer's relevant income or expenses, regardless of whether they increase or decrease the amount of tax due or refund.

Having the taxpayer present in the tax preparer's site is not always possible. In these cases, Virtual VITA/ TCE processes can be used to prepare returns without taxpayer being in-person. Certified volunteers may interview taxpayers over the phone while preparing their return. The alternative process used to prepare returns must be approved by the responsible IRS Territory Manager prior to the start of the filing season to ensure all procedures are in place as described in the Quality Site Requirements (QSR). Most importantly, the taxpayer's and government's interests must be properly protected. In some cases, the taxpayer information must be left at the site to be prepared and mailed to the taxpayer. Adequate security and privacy is expected to ensure taxpayer records are properly safeguarded.

Some individuals may attempt to defraud the government by filing false tax returns. If you have any question about the validity of information provided by a taxpayer, or are uncomfortable with a taxpayer situation, discuss your concern with your Coordinator.

If you or a taxpayer have a concern or issue regarding unethical behavior at a site, **mailto:wi.voltax@irs. gov.** The email notification should include your name, contact number, site name, and a detailed description of the incident including the individual's full name, date the incident occurred and the number of taxpayer's affected by the violation if applicable. Also, see Publication 730, Important Tax Records Envelope (VITA/ TCE), Publication 4454, Your Civil Rights Are Protected, or Publication 4053, Your Civil Rights Are Protected Poster for IRS Assisted

Programs, for reporting Civil Rights (Title VI) and EEO concerns.

Taxpayer Civil Rights

The Department of the Treasury – Internal Revenue Service will not tolerate discrimination based on race, color, national origin (including limited English proficiency), disability, reprisal, sex (in education programs or activities) or age in programs or activities receiving federal financial assistance from the Internal Revenue Service.

If a taxpayer believes that he or she has been discriminated against, a written complaint should be sent to:

Operations Director, Civil Rights Unit
Internal Revenue Service, Room 2413
1111 Constitution Avenue, NW
Washington, DC 20224

For all questions about taxpayer civil rights, contact us at the above address, or by e-mail at **edi.civil.rights.division@irs.gov**

Do not send tax returns, payments, or other non-civil rights information to this address.

What resources are available if the taxpayer has an unresolved tax issue from prior years?

When talking with the taxpayer, a volunteer may discover that the taxpayer has other unresolved tax issues. It may be more likely that the taxpayer is experiencing difficulties with the IRS when the taxpayer checked “yes” to the following questions on Form 13614-C:

- Part I Q11. Have you, your spouse, or dependents been a victim of tax related identity theft or been issued an Identity Protection PIN?

- Part V Q2. Have credit card, student loan or mortgage debt canceled/forgiven by a lender or have a home foreclosure?
- Part V Q4. Have Earned Income Credit, Child Tax Credit or American Opportunity Credit disallowed in a prior year? Disallowed credits
- Page 3 Q4. If you have a balance due, would you like to make a payment directly from your bank account?
- Page 3 Q6. Did you, or your spouse if filing jointly, receive a letter from the IRS?

When talking about their responses to these questions, if it appears that there are unresolved issues for the taxpayer, volunteers can assist the taxpayer by providing them with a referral to the local Low Income Taxpayer Clinic (LITC) that may be able to help. LITCs are independent from the IRS and the Taxpayer Advocate Service (TAS). LITCs represent taxpayers whose income is below a certain level and who need to resolve tax problems with the IRS. LITCs can represent taxpayers in audits, appeals, and tax collection disputes before the IRS and in court. In addition, LITCs can provide information about taxpayer rights and responsibilities in different languages for individuals who speak English as a second language. Services are offered for free or a small fee.

For more information or to find an LITC, see the LITC page at **www.TaxpayerAdvocate.irs.gov/litc**, download IRS Publication 4134, Low Income Taxpayer Clinic List, at **www.irs.gov** or call the IRS at 1-800-829-3676.

The Taxpayer Advocate Service is Here to Help

The Taxpayer Advocate Service (TAS) is an ***independent*** organization within the Internal

Revenue Service (IRS), led by the National Taxpayer Advocate, that helps taxpayers and protect taxpayer rights. TAS offers free help to taxpayers when a tax problem is causing a financial difficulty, when they've tried and been unable to resolve their issue with the IRS, or when they believe an IRS system, process, or procedure just isn't working as it should. TAS strives to ensure that every taxpayer is treated fairly and knows and understands their rights under the Taxpayer Bill of Rights.

TAS has offices in every state, the District of Columbia, and Puerto Rico. To find your local advocate's number:

- Visit us at **www.TaxpayerAdvocate.irs.gov/contact-us**;
- Check your local directory; or
- Call TAS toll-free at 877-777-4778.

The Taxpayer Advocate Service's website, www.TaxpayerAdvocate.irs.gov, is a resource for all taxpayers. It covers a variety of tax-related concepts and problems, breaking each down to describe what taxpayers should know, what they should do, and where they can get more help if needed. Taxpayers can also learn about their taxpayer rights.

What is the Taxpayer Bill of Rights?

The Taxpayer Bill of Rights groups rights from the Internal Revenue Code into ten fundamental taxpayer rights. IRS employees are responsible for knowing and following these rights. See IRC § 7803(a)(3). For more information, see Publication 1, Your Rights as a Taxpayer, or visit **www.TaxpayerAdvocate.irs.gov/taxpayer-rights**.

How else does the Taxpayer Advocate Service help taxpayers?

TAS works to resolve large-scale problems that affect many taxpayers. Please report systemic issues at **www.irs.gov/sams**. (Be sure not to include any personal identifiable information)

Are there other materials available to assist me?

When you arrive at the tax preparation site, your Coordinator will assist you with your resource needs. Your site may even have a technical research library from which you can access various forms, publications, and worksheets. These materials can also be downloaded from **www.irs.gov**.

You should **not** use this guide at your tax preparation site; it is designed for training purposes only. The Volunteer Resource Guide will be available for use in printed or electronic format. Publication 17 will be available in electronic format. Your Coordinator should be able to provide access to the following key resources as well:

- Instruction booklets, schedules, and worksheets for Form 1040
- Frequently used tax publications (e.g., Publication 596, Earned Income Credit and Publication 3, Armed Forces' Tax Guide)
- Equipment and supplies along with security requirements and use restrictions

Recipients of government property and equipment must certify that the equipment will be used for volunteer tax return preparation purposes. Commercial and certain personal uses of the property may terminate the agreement. This applies to hardware and software, as well as supplies.

You may reinforce your knowledge of tax law by viewing online training courses such as

Link & Learn Taxes, found at **apps.irs.gov/app/vita/**.

A toll-free tax information hotline is available for volunteer use only. If you have a tax law question and cannot get the answer from your Coordinator or your reference material, call 1-800-829-8482 (1-800-TAX-VITA). **Do not give this phone number to taxpayers.** The volunteer hotline is generally available from February 1 until the filing deadline.

For inquiries about refund offsets, taxpayers can call the Treasury Offset Program toll-free at 1-800-3043107. Other helpful contact information can be found near the back of the Volunteer Resource Guide.

How do I get started using the tax software?

The majority of VITA/TCE sites use IRS-sponsored tax preparation software. The tax software is used to prepare returns and includes a help feature to assist in understanding the application of tax law; it is available in both desktop and online (internet-based) versions.

Your instructor or Coordinator will provide you with the information, user names, and passwords required for logging into the program for training and tax preparation purposes.

Where do I find information about the tax software?

The Volunteer Resource Guide contains step-by-step procedures for electronic return preparation and helpful hints for using the tax software within each applicable tax law topic. Information about completing the return is listed in the Volunteer Resource Guide, Tab K, Finishing the Return.

Summary

Welcome to the VITA/TCE programs. Remember:

- Make sure you have the resources and support you need to provide each taxpayer with high-quality service and an accurate return.
- A return is accurate when tax law is applied correctly and the return is free from error based on the taxpayer's interview and supporting documentation, and a completed Form 13614-C, Intake/Interview and Quality Review Sheet (or Form 13614-NR).
- Know your roles and responsibilities, adhere to the Volunteer Standards of Conduct, and follow due diligence.
- Prepare returns that are:
  - within the scope of the VITA/TCE programs
  - within your certification level

- Use VITA/TCE equipment and supplies (including hardware and software) for their intended purposes.
- Know the procedures for helping a taxpayer with identity theft.

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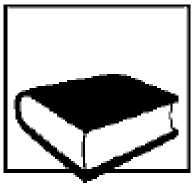
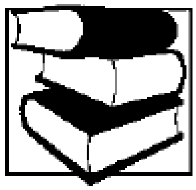
Temporary Provisions

Introduction

Some of the provisions contained in this lesson have been commonly referred to as "extenders." Others are temporary provisions contained in recent legislation. In some instances, these provisions modify only portions of the existing tax law. In those cases, we have included caution statements in the affected lessons redirecting volunteers to explore the temporary modifications in this lesson. The following topics are covered here:

- Student loan forgiveness
- Employer provided educational assistance
- Higher education emergency financial aid grants

- Cancellation of debt on a principal residence

Taxpayers who made timely repayments in 2023 of their 2020 coronavirus-related distributions may amend the prior year return to claim the repayment. Refer to the retirement income lesson for details. The expansion through 2025 of the premium tax credit (PTC) is covered in the Premium Tax Credit lesson.

What temporary provisions should I be aware of?

Student loan forgiveness

An exclusion from gross income is available for student loan forgiveness after 2020 and before 2026 for most forgiven student loans. If eligible for the exclusion, the lender should not issue Form 1099-C.

Exclusion for certain employer payments of student loans

Employers may provide a student loan repayment benefit to employees on a tax-free basis. Under the provision, an employer may contribute up to $5,250 annually toward an employee’s student loans, and such payment would be excluded from the employee’s income. The $5,250 cap applies to both the new student loan repayment benefit as well as other educational assistance (e.g., tuition, fees, books) provided by the employer. This provision has been extended through 2025.

Higher education emergency financial aid grants

Emergency financial aid grants under the CARES Act for unexpected expenses, unmet financial need, or expenses related to the disruption of campus operations due to the COVID-19 pandemic, such as unexpected expenses for food, housing, course materials, technology, health care, or childcare, are qualified disaster relief payments under section 139 of the Internal Revenue Code. Available through September 30, 2023, this grant is not includible in gross income. Further, the student’s qualified education expenses are not reduced for this nontaxable grant for an education benefit.

Cancellation of Debt (COD) – Principal Residence

Cancellation of credit card debt is included in the Other Income lesson of this publication for Advanced certification. Exclusion from gross income of qualified principal residence indebtedness has been extended through 2025 on a modified basis.

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

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 the collateral (home, car, etc.). 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 foreclose on the home only. 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.

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 lesson.

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, Canceled Debts, Foreclosures, Repossessions, and Abandonments.

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.

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.

	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 for 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	The amount realized includes the balance of the nonrecourse

	property and the adjusted basis	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.

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, in addition to the general exclusion noted above for tax years 2021 through 2025 (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.

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

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

Discharge of Qualified Principal Residence Indebtedness

Taxpayers may exclude from income certain debt forgiven or canceled on their principal residence. 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 1099C, including the information that would be reported on Form 1099-A.

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

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 for discharges after 2020 and through 2025 is $750,000 ($375,000 in the case of a married individual filing a separate return).

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 $750,000 ($375,000 in the case of a married individual filing a separate return)

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.

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.

EXERCISE

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 Advanced 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?

a. Yes

b. 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?

a. Yes

b. No

State tax laws may differ.

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.

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 and some surviving spouses) for a gain on the sale of a principal 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 excludible 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, Schedule 1 and is beyond the scope of VITA/TCE

If the canceled debt is reportable on Form 1040, Schedule 1 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.

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

For more information on determining the basis for sale of residence see the lesson on Income – Capital Gain or Loss, Publication 523, Selling Your Home, or Publication 551, Basis of Assets.

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 on Form 8949 and Schedule D. A loss on the disposition of a personal asset is not deductible.

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 and certain surviving spouses), 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.

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, Schedule 1.

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. Refer to the Volunteer Resource Guide, Tab EXT, Legislative Extenders, for details. 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, Tab EXT, Legislative Extenders, Entering Forgiveness of Qualified Principal Residence Indebtedness, for directions on completing 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 Volunteer Resource Guide, Tab D, Capital Gains or Losses Sale of Main Home.

Case Study – Reporting a Foreclosure and Canceled Debt

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.

Frank bought his home on May 14, 2017. 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.

Form 1099-C & Form 8949:

☐ 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 $ **20,000.00** 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**		**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 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	05/14/17	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**

Schedule D (Form 1040) & Form 982:

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 [illegible] transactions [illegible] 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.

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Form 1099-C & Form 982

☐ 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 $ **20,000.00** 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: **FRANK LINCOLN**
Identifying number: **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:

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		

Question 3: A volunteer with Advanced certification is working with Robert. Following up to a "yes" answer on the Intake & Interview Sheet, 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

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

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

Summary

This lesson included the following temporary changes. Refer to the retirement income lesson for deferred Coronavirus-related distributions. Changes to the premium tax credit are discussed later in the Premium Tax Credit lesson.

Student loan forgiveness and Higher Education Emergency Financial Grants

Both of these provisions represent nontaxable income to the recipient. Further, the recipient’s qualified education expenses are not reduced and can be fully used for an education credit or other benefit, if otherwise eligible.

Cancellation of Debt (COD) – Principal Residence

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.

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.

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.

- Cancellation of debt on a residence other than a qualified principal residence
- 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: b, 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: b, 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 in 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.

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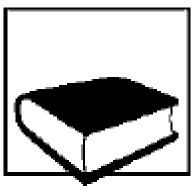
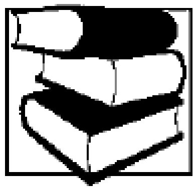
Filing Basics

Introduction

This lesson will help you determine which taxpayers must or should file a tax return. You will also find information on how to verify a taxpayer’s identity, which form to use, and completing the Basic Information Section.

Objectives

At the end of this lesson, using your reference materials, you will be able to:

- Determine who *must* file a tax return
- Determine who *should* file a tax return
- Verify the taxpayer’s identity
- Determine how to file the return

What do I need?

- Form 13614-C
- Publication 4012
- Publication 17

Optional:

- Publication 559
- Form 1040 Instructions
- Publication 4299

Who must file?

U.S. citizens or residents of the United States must file a return based on three factors. There are special rules for dependents, surviving spouses, U.S. citizens and residents living outside the U.S., residents of Puerto Rico, and individuals with income from U.S. territories.

Remember to use the interview techniques and tools when determining who must file.

What do I need to know?

To decide whether someone must file a tax return, you need to know the individual's:

- Age
- Gross income
- Filing status

Where do I get information on the taxpayer's age?

Look at the intake and interview sheet for the taxpayer's date of birth. Confirm this date during the interview. Refer to the sample Intake/Interview and Quality Review sheet in the Volunteer Resource Guide, Tab B, Starting a Return and Filing Status.

Where do I get information on the taxpayer's gross income?

An approximation of gross income is enough to see if a taxpayer must file a return. Gross income is **all** the income the taxpayer received during the tax year in the form of money, goods, property, and services that is not exempt from tax. It includes both earned and unearned income.

The Income section of the Volunteer Resource Guide lists the sources of income that should be included and excluded in determining a person's gross income. You can also refer to the Income lessons in this training guide.

To approximate gross income:

- Add the amounts from all the taxpayer's Form(s) W-2, Box 1
- Add taxable amounts reported on any Form(s) 1099
- Using the intake and interview sheet, review the income questions with the taxpayer to see if there was any additional income not reported on Form W-2 or Form 1099 and determine each amount

Total the above amounts to determine the taxpayer's approximate gross income.

Do not include Social Security benefits when determining filing requirement unless the taxpayers are married, are filing a separate return, and lived with their spouse at any time during the tax year.

Where do I get information on the taxpayer's filing status?

Taxpayers may or may not know which filing status to use. For the purposes of determining whether a person must file a return, narrowing the choices down to the most likely filing status(es) is adequate in most cases.

Check the Taxpayer Information section of the intake and interview sheet for:

- The taxpayer's marital status
- Whether the taxpayer can be claimed as a dependent on someone else's tax return

- The taxpayer's potential dependents

Use the Volunteer Resource Guide's Determination of Filing Status decision tree and the Interview Tips in Tab B, Starting a Return and Filing Status, for helpful probing questions.

Who is legally required to file a federal tax return?

To determine whether a taxpayer is legally required to file a return, start with the Volunteer Resource Guide, Tab A, Who Must File. Use the charts to review the examples.

Lucy is 36 years old and single, and her gross income is $20,000. She must file a tax return since her income exceeds the amount for her age and filing status.

Henrietta and Javier are married and plan to file a joint return. Henrietta is 67 and had a gross income of $11,000 for the tax year. Javier is 66. His gross income was $5,000 for the year. Since their combined gross income is less than the minimum amount for their ages and filing status, they do not have to file a return.

What are special situations that require a taxpayer to file?

If the Who Must File charts show that an individual is not required to file a return, then continue to Chart C – Other Situations When You Must File in the Volunteer Resource Guide to see if any of the special conditions require the person to file.

The most common special situations when individuals are legally required to file a return are:

- Self-employed with net earnings of $400 or more
- Taxpayers who owe special taxes
- Taxpayers who received advanced payments of the premium tax credit (APTC) for themselves, their spouse, or a dependent

Taxpayers who received the 2008 first-time homebuyer credit are required to file a return to repay a portion of the credit.

EXERCISES

Refer to the Who Must File section of the Volunteer Resource Guide to answer these questions. Answers are at the end of the lesson summary.

Question 1: Bob is 27 years old and single. His gross income was $17,000 during the tax year. Based only on this information, is he required to file a tax return?

a. Yes

b. No

Question 2: Janet and Harry are married, file jointly, and lived together all year. During the tax year, she turned 66 and he turned 64. Their gross income was $19,800. Based only on this information, are they required to file a tax return?

a. Yes

b. No

Question 3: Juanita has a dependent child and can file as a Qualifying Surviving Spouse. She is 47 years old. Her gross income was $27,000. Based only on this information, is she required to file a tax return?

a. Yes

b. No

Who should file?

Even if individuals are not required to file a tax return, they should file a return if they qualify for certain credits or a refund. These items are listed in the Volunteer Resource Guide, Tab A, Who Must File.

Individuals *should* file a return if they are eligible to claim:

- A refund of withheld taxes
- The earned income credit (EIC)
- The additional child tax credit
- Premium tax credit
- The American opportunity credit

Taxpayers who should file may be entitled to a refundable tax credit, and filing a return is the only way to get it. Individuals who are not required to file a federal return may benefit by filing for state purposes.

A nonrefundable credit is a dollar-for-dollar reduction of the tax liability. A nonrefundable credit can only reduce the tax liability to zero. A refundable credit can zero out the tax liability and result in a cash refund to the taxpayer.

How do I find out if a taxpayer is eligible to claim a refund or refundable credit?

The taxpayer may qualify for a tax refund, earned income credit, additional child tax credit, premium tax credit, or American opportunity credit if:

- Federal or state income tax was withheld on any income form
- The taxpayer had earned income
- The taxpayer has a qualifying child
- The taxpayer or their dependent paid higher education expenses

- The taxpayer made estimated tax payments
- The taxpayer purchased health coverage through the marketplace

The earned income credit may apply with or without a child. See the Earned Income Credit and Child Tax Credit lessons for details on determining eligibility.

If a taxpayer is not required to file a tax return, and you are uncertain if they will benefit from filing, begin a return to determine if filing a tax return would benefit the taxpayer.

How do I verify taxpayer identity?

As the first step in the interview process, you should verify the identity of the taxpayer(s), address, and the spelling of names entered on the taxpayer's intake and interview sheet.

What documents do I use to verify identity?

Ask to see original photo identification such as:

- Valid driver’s license (U.S.)
- Visa
- State ID (U.S.)
- Military ID
- Passport
- National ID
- Employer ID
- School ID

Judgment should be used in accepting any other valid form of identification. For example, the Coordinator can allow proof of identity of an elderly person with a disability who has an expired driver’s license and passport but also provides a valid birth certificate. IRS-tax-law certified volunteers preparing tax returns are required to confirm the identity of the taxpayer to avoid identity theft, tax fraud, and to validate the correct name and Social Security number. If a taxpayer cannot prove their identity, or if the volunteer is uncomfortable accepting the items presented as proof of identity, the taxpayer should be advised to return with an acceptable form of identification.

Exceptions to requiring photo ID should only be made under extreme circumstances and should be approved by the Coordinator. For example, there may be limited situations where an exception may apply to a person with a disability, the elderly, or other unique circumstances. Additionally, the Coordinator has discretion to approve exceptions to verification of taxpayer identity rules. Refer to Publication 4299, Privacy, Confidentiality and Civil Rights for additional information.

A spouse who is Married Filing Separately is not required to provide the Social Security card for the other spouse, although the return cannot be e-filed without the spouse's Social Security number.

In addition to photo identification for taxpayers, they must also present proof of taxpayer identification numbers (TIN) for themselves and all persons listed on their tax return. (TIN is explained in the next section.) Exceptions to this rule should be rare and only the Coordinator has discretion to approve an exception.

Taxpayers who **cannot** prove their identity should seek professional tax assistance.

What about taxpayers filing for decedents?

If you are assisting someone who is filing a return for a decedent:

- Be aware that volunteers need to take steps to protect a taxpayer's identity and avoid possible identity theft.
- Ask to see the surviving spouse's identification or a copy of the death certificate.
- A personal representative may be filing the return for the deceased taxpayer. Verify the identity of the person who is filing for the decedent and ask if they have court documents or other documentation authorizing them to file the tax return.
- Representatives or surviving spouses who do not have the necessary documentation with them should be advised to return

once they have the information. If they cannot provide the information, refer them to a professional tax preparer.

For additional information about filing a return for a decedent, refer to the Return Signature in the Volunteer Resource Guide, Tab K, Finishing the Return, Form 1040 Instructions, Form 1310, Publication 17, or Publication 559.

What are Taxpayer Identification Numbers?

IRS regulations require that each person listed on a U.S. federal income tax return have a valid Taxpayer Identification Number (TIN). The types of TINs are:

- Social Security Number (SSN)
- Individual Taxpayer Identification Number (ITIN)
- Adoption Taxpayer Identification Number (ATIN)

Who has a Social Security number?

Any individual who is legally eligible for employment in the United States must have a Social Security number. All cards issued by the Social Security Administration are valid for income tax purposes. “Valid for work only with DHS authorization” is marked on the card for people lawfully admitted to the U.S. on a temporary basis who have DHS authorization to work. That is, they are valid for work. “Not valid for employment” is marked on the card for people who are either lawfully admitted without work authorization or because they are required to have a Social Security number to get a benefit or service.

Some Canadians have both U.S. and Canadian Social Security numbers. Never use the Canadian number on a U.S. tax return.