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Bankruptcy Tax Guide

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If the IRS does select the estate's return for examination and redetermines the tax shown on the return, the trustee may contest the IRS's determination in bankruptcy court. See *Bankruptcy Court*, later.

The automatic stay. When the debtor files a petition with the bankruptcy court, the debtor receives the protection of the automatic stay. The automatic stay arises as a matter of law and, with certain exceptions, suspends most collection activity. The automatic stay applies to all entities, including governmental units.

The automatic stay prohibits acts to collect taxes that arose before the bankruptcy filing. IRS collection actions such as serving Notices of Federal Tax Lien or Levy are prohibited if they were intended to collect pre-bankruptcy debts or property of the estate. The automatic stay also stops the commencement or continuation of civil actions, including certain Tax Court cases.

Generally, the automatic stay to collect taxes continues until either the bankruptcy court lifts the stay, the bankruptcy case is closed or dismissed, or the debtor receives a discharge.

Note. The stay against property of the estate does not end (as long as the property is in the estate) unless the stay is lifted (removed).

Tax audits and the automatic stay. The automatic stay does not prohibit the IRS from determining the amount of a tax that is owed. The automatic stay does not prohibit:

1. An audit to determine tax liability,
2. A demand for tax returns,
3. The issuance of a Notice of Deficiency,
or
4. Assessing a tax and sending a notice
and demand for payment.

Assessment of tax. Assessment is the statutorily required recording of a tax liability. During a bankruptcy case, the IRS may make

an assessment of tax due and issue a notice and demand for payment. This grant of authority is a specific exception to the “automatic stay” rules discussed below.

Accordingly, after the correct amount of tax is determined by the IRS, bankruptcy court, or Tax Court, the IRS may assess the tax due against the bankruptcy estate and issue a notice and demand for payment.

Statute of limitations for collection. In a bankruptcy case, the period of limitations for collection of tax (generally, 10 years from the date of assessment) is suspended for the period during which the IRS is prohibited from collecting, plus 6 months thereafter.

Offsets of refunds during the automatic stay. Generally, the automatic stay prevents the IRS from offsetting the refund against a tax liability; however, the IRS may freeze the refund until the stay is lifted. The IRS can offset a pre-petition income tax refund

against a pre-petition income tax liability while the automatic stay is in effect.

Requests for Refund or Credit

If the debtor has already claimed a refund or credit for an overpayment of tax on a properly filed return or claim for refund, the trustee may rely on that claim. However, if the credit or refund was not claimed by the debtor, the trustee may make the request on behalf of the bankruptcy estate by filing the original or amended return or form with the Internal Revenue Service, Centralized Insolvency Operation, P.O. Box 7346, Philadelphia, PA 19101-7346 (marked "Request for Prompt Refund" and accompanied by a written statement explaining that the request is being submitted pursuant to section 505(a) of the Bankruptcy Code). See Revenue Procedure 2010-27, as modified by Announcement 2011-77.

The appropriate form for the trustee to use in making the claim for refund is as follows.

1. For income taxes for which an individual debtor filed a Form 1040 or 1040-SR, the trustee should use a Form 1040-X, Amended U.S. Individual Income Tax Return.
2. For income taxes for which a corporate debtor filed a Form 1120, the trustee should use a Form 1120-X, Amended U.S. Corporation Income Tax Return.
3. For income taxes for which a debtor filed a form other than Form 1040 or 1040-SR, or Form 1120, the trustee should use the same type of form that the debtor had originally filed, and write "Amended Return" at the top of the form.
4. For taxes other than certain excise taxes or income taxes for which the debtor filed a return, the trustee should use a Form 843, Claim for

Refund and Request for Abatement, and attach an exact copy of any return that is the subject of the claim along with a statement of the name and location of the office where the return was filed.

5. For excise taxes reported on Form 720, 730, or 2290, the trustee should use Form 8849, Claim for Refund of Excise Taxes, or Form 720-X, Amended Quarterly Federal Excise Tax Return, as appropriate.
6. For overpayment of taxes of the **bankruptcy estate** incurred during the administration of the case, the trustee may use a properly executed tax return (for income taxes, a Form 1041) as a claim for refund or credit.

Once the IRS receives the trustee's claim for refund, it will examine the refund claim on an expedited basis and notify the trustee of its decision within 120 days from the date of the

filing of the claim. If the trustee disagrees with the IRS's decision or does not receive a decision from the IRS within 120 days of filing the claim, the trustee may seek a determination from the bankruptcy court to determine the estate's right to the refund.

Excessive and erroneous tax refunds paid to the bankruptcy estate. Taxpayers who have net losses can sometimes carry back the losses to previous years where taxes were paid to reduce the liability in the prior year, which generate a refund. Such taxpayers may also make a special request for a refund, known as a tentative carryback adjustment (also called a "quickie refund"). A tax liability arising from an excessive allowance for a quickie refund payable to the bankruptcy estate is given second priority treatment as an administrative expense. However, an erroneous refund or credit other than a quickie refund paid to the bankruptcy

estate receives the same priority as the underlying tax. See *Federal Tax Claims*, later.

Court Jurisdiction Over Tax Matters

Bankruptcy Court

Determination of tax liability. Generally, the bankruptcy court has the authority to determine the amount or legality of any tax imposed on a debtor under its jurisdiction and the bankruptcy estate, including any fine, penalty, or addition to tax, whether or not the tax was previously assessed or paid.

The bankruptcy court does **not** have authority:

1. To determine the amount or legality of a tax, fine, penalty, or addition to tax that was contested before and adjudicated by a court or administrative tribunal of competent

jurisdiction before the date of the bankruptcy petition filing; or

2. To decide the right of a tax refund for the bankruptcy estate before the earlier of:
 - A determination for refund by the IRS or other governmental unit, or
 - 120 days since the trustee properly requested the refund.

Tax Court

Tax Court proceedings. The filing of a bankruptcy petition results in an automatic stay immediately stopping the commencement or continuation of certain Tax Court proceedings. In individual bankruptcy cases, the stay prohibits the commencement of a Tax Court case regarding the tax liabilities of the debtor for tax periods ending before the bankruptcy court's order for relief.

If the debtor is a corporation, the automatic stay prohibits the commencement or continuation of Tax Court proceedings relating to liabilities for tax periods that the bankruptcy court may determine. Generally, in corporate chapter 11 cases, the bankruptcy court determines the debtor corporation's tax liabilities for tax periods ending before the date a plan of reorganization is confirmed.

The bankruptcy court has the power to lift the automatic stay and allow the debtor to begin or continue a Tax Court case. Accordingly, during the pendency of the bankruptcy case, in effect, the bankruptcy court has the sole authority to determine whether the tax issue will be decided by the bankruptcy court or Tax Court.

Suspension of time for filing. In any bankruptcy case, the 90-day period for filing a Tax Court petition after the issuance of the Statutory Notice of Deficiency is suspended for the time the debtor is prevented from

filing the petition due to the bankruptcy case, and for an additional 60 days thereafter.

Accordingly, if the Statutory Notice of Deficiency was issued before the bankruptcy petition was filed, and the 90-day period had not expired, the running of the 90-day period will be suspended while the stay prevents the commencement of the Tax Court case. The 90-day period will begin to run 60 days after the stay against filing the petition ends. The suspension is effective for any part of the 90-day period remaining on the date of the bankruptcy petition filing.

However, the 90-day period for filing a Tax Court petition after issuance of a Notice of Determination in an innocent spouse case isn't suspended by filing of a bankruptcy petition. Thus, if the IRS issues a final Notice of Determination denying the debtor's request for innocent spouse relief during the bankruptcy case, the debtor is prohibited from petitioning the Tax Court while the

automatic stay is in effect; however, the 90-day period for petitioning the Tax Court isn't suspended. In these circumstances, the debtor must file a motion with the bankruptcy court asking the bankruptcy court to lift the automatic stay. If the bankruptcy court lifts the stay, then the taxpayer can petition the Tax Court so long as the 90 days for petitioning hasn't expired.

Trustee may intervene. The trustee of a bankruptcy estate in any title 11 bankruptcy case may intervene on behalf of the estate in a proceeding in the Tax Court to which the debtor is a party.

Federal Tax Claims

Proof of claim. Upon filing a bankruptcy petition, as a result of the automatic stay, the debtor's assets in the bankruptcy estate under the jurisdiction of the bankruptcy court aren't subject to levy. However, creditors may file a "proof of claim" with the bankruptcy

court to protect their rights. The IRS may file a proof of claim with the bankruptcy court in the same manner as other creditors. This claim may be filed with the bankruptcy court even though taxes haven't been assessed or are subject to a Tax Court proceeding.

Secured tax claims. If the IRS filed a Notice of Federal Tax Lien (NFTL) before the bankruptcy petition was filed, the IRS will have a secured claim in the bankruptcy case to the extent the lien attached to equity in the debtor's assets. In chapter 7 cases, in certain circumstances, the trustee may be able to subordinate the tax lien in order to pay certain non-tax priority claims. In chapter 11 cases, if the secured claim would otherwise have been entitled to treatment as a priority claim, the chapter 11 plan must provide for the secured tax claim in the same manner, over the same period, as an unsecured eighth priority tax claim.

Unsecured Tax Claims

Eighth priority taxes. In general, certain unsecured debts are given priority for payment purposes. Certain tax debts arising before the bankruptcy case was filed are classified as eighth priority claims.

The following federal taxes, if unsecured, are eighth priority taxes of the government.

1. Income taxes on or measured by income or gross receipts for a tax year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after 3 years before the date of the filing of the bankruptcy petition.
2. Income taxes on or measured by income or gross receipts assessed within 240 days before the date of the filing of the petition. The 240-day period is exclusive of any time during

which an offer in compromise for that tax was pending or in effect during that 240-day period plus 30 days, and exclusive of any time during which a stay of proceedings against collections was in effect in a prior case during the 240-day period plus 90 days.

3. Income taxes that were not assessed before the bankruptcy petition date, but were assessable as of the petition date, unless these taxes were still assessable solely because no return was filed, a late return was filed within 2 years of the filing of the bankruptcy petition, a fraudulent return was filed, or because the debtor willfully attempted to evade or defeat the tax.
4. Withholding taxes that were incurred in any capacity.
5. Employer's share of employment taxes on wages, salaries, or commissions (including vacation, severance, and

sick leave pay) paid as priority claims under title 11 U.S.C. section 507(a)(4), or for which a return was last due within 3 years of the filing of the bankruptcy petition, including a return for which an extension of the filing date was obtained.

6. Excise taxes on transactions occurring before the date of filing the bankruptcy petition, for which a return, if required, is last due (including extensions) within 3 years of the filing of the bankruptcy petition. If a return isn't required, these excise taxes include only those on transactions occurring during the 3 years immediately before the date of filing the petition.

Payment of Tax Claims

Chapter 7 cases. In a chapter 7 case, eighth priority taxes may be paid out of the assets of the bankruptcy estate to the extent assets

remain after paying the claims of secured creditors and other creditors with higher priority claims.

Chapter 11, 12, and 13 cases. Different rules apply to payment of eighth priority pre-petition taxes under chapters 11, 12, and 13.

1. A chapter 11 plan can provide for payment of these taxes, with post-confirmation interest, over a period of 5 years from the date of the order for relief issued by the bankruptcy court (this is the bankruptcy petition date in voluntary cases), in a manner not less favorable than the most favored non-priority claims (except for convenience claims under section 1122(b) of the Bankruptcy Code).
2. In a chapter 12 case, the debtor can pay such tax claims in deferred cash payments over time. However, pursuant to Bankruptcy Code section 1232, an unsecured priority tax claim

arising from the sale of farm assets shall be treated as a non-priority unsecured claim.

3. In a chapter 13 case, the debtor can pay such taxes over 3 years or over 5 years with court approval.

Higher priority taxes. Certain taxes are assigned a higher priority for payment. Taxes incurred by the bankruptcy estate are given second priority treatment, as administrative expenses. In an involuntary bankruptcy case, taxes arising in the ordinary course of business or the debtor's financial affairs (after the filing of the bankruptcy petition but before the earlier of the appointment of a trustee or the order for relief) are included in the third priority payment category. If the debtor has employees, the employees' portion of employment taxes on the first \$13,650 (this amount adjusted every 3 years) of wages that they earned during the 180-day period before the date of the bankruptcy filing or the

cessation of the business (whichever occurs first) is given fourth priority treatment.

However, the debtor's portion of the employment taxes on these wages, as the employer, is given eighth priority treatment.

Penalties. A tax penalty which is punitive in nature, that is, not for actual pecuniary (monetary) loss, is payable as a general unsecured claim.

Relief from certain penalties. A penalty for failure to pay tax, including failure to pay estimated tax, is not imposed if the tax was incurred by the bankruptcy estate as a result of an order of the court finding probable insufficiency of funds of the bankruptcy estate to pay administrative expenses.

If the tax was incurred by the debtor, the penalty is not imposed if:

1. The tax was incurred before the earlier of the order for relief or (in an

involuntary case) the appointment of a trustee, and

2. The bankruptcy petition was filed before the due date for the tax return (including extensions) or the date for imposing the penalty occurs on or after the day the bankruptcy petition was filed.

Note. Relief from the failure-to-pay penalty does not apply to any penalty for failure to pay or deposit tax withheld or collected from others which is required to be paid over to the U.S. government. Nor does it apply to any penalty for failure to file a timely return.

FUTA credit. Employers are generally allowed a credit against FUTA for contributions made to a state unemployment fund if the contributions are paid by the last day for filing a federal unemployment tax return for the tax year.

If contributions are paid to the state fund after such date, the allowable credit shall not exceed 90% of the otherwise allowable credit that may be taken against FUTA. However, in the case of wages paid by the trustee of a title 11 bankruptcy estate where the failure to timely pay state unemployment contributions was without fault by the trustee, 100% of the credit is allowed. An employer may also receive an additional credit against FUTA contributions. See Pub. 15, (Circular E), Employer's Tax Guide, for additional information.

Discharge of Unpaid Tax

The bankruptcy court may enter an order discharging the debtor from personal liability for certain debts, including taxes. The order for discharge is a permanent order of the court prohibiting the creditors from taking action against the debtor personally to collect the debt. However, secured creditors with

valid pre-bankruptcy liens may enforce them to recover property secured by the lien.

Not all debts are dischargeable. Many tax debts are excepted from the bankruptcy discharge. The scope of the bankruptcy discharge depends on the chapter under which the case was filed and the nature of the debt. Chapter 7 debtors don't have an absolute right to a discharge; objections may be filed by creditors. Chapters 12 and 13 debtors are generally entitled to discharge upon completion of all payments under the bankruptcy plan.

Chapter 7 cases. For individuals in chapter 7 cases, the following tax debts (including interest) aren't subject to discharge.

- Taxes entitled to eighth priority.
- Taxes for which no return was filed.
- Taxes for which a return was filed late after 2 years before the bankruptcy petition was filed.

- Taxes for which a fraudulent return was filed.
- Taxes that the debtor willfully attempted to evade or defeat.

Penalties in a chapter 7 case are dischargeable unless the event that gave rise to the penalty occurred within 3 years of the bankruptcy and the penalty relates to a tax that isn't discharged. Only individuals may receive a discharge in chapter 7 cases; corporations and other entities don't.

Chapter 11 cases. The same exceptions to discharge that apply to individuals in chapter 7 cases also apply to individuals in chapter 11 cases. However, different rules apply to corporations. A corporation in a chapter 11 case may receive a broad discharge when the reorganization plan is confirmed; however, secured and priority claims must be satisfied under the plan. There is an exception to discharge for taxes for which the debtor filed

a fraudulent return or willfully attempted to evade or defeat.

Chapter 13 cases. A debtor who completes all payments under the chapter 13 plan shall receive a broad discharge of all debts provided for by the plan. However, priority tax claims **must** be paid in full under the chapter 13 plan. The following taxes are excepted from the broad chapter 13 discharge.

- Withholding taxes for which the debtor is liable in any capacity.
- Taxes for which no return was filed.
- Taxes for which a return was filed late after 2 years before the bankruptcy petition was filed.
- Taxes for which a fraudulent return was filed.
- Taxes that the debtor willfully attempted to evade or defeat.

Also, there is an exception from discharge for debts where the creditor, including the IRS, did not receive notice of the chapter 13 bankruptcy case in time to file a claim.

Chapter 13 "Hardship Discharge." In cases where the failure to complete all payments under the chapter 13 plan was due to circumstances for which the debtor should not be held accountable, the bankruptcy court may grant a "hardship discharge." However, all unsecured claims **must** be paid an amount not less than they would have received in a chapter 7 liquidation. Debts that would be excepted under an individual chapter 7 discharge are also excepted from the chapter 13 hardship discharge.

Chapter 12 cases. The same tax debts that are excepted from discharge in chapter 7 cases of individuals are excepted from discharge in chapter 12 cases of individuals. The exceptions don't apply to chapter 12 cases of non-individuals. As in chapter 13

cases, the debtor may be granted a hardship discharge if appropriate.

Federal Tax Liens. If a tax is discharged, the discharged tax may still be collectable from the debtor's pre-bankruptcy property if the IRS filed a Notice of Federal Tax Lien (NFTL) before the bankruptcy petition was filed. Perfected liens generally pass through bankruptcy proceedings unaffected, even if the debtor's personal liability for the debt is discharged. If the IRS did not file an NFTL before the bankruptcy petition was filed, the tax lien will be removed from the debtor's pre-bankruptcy property if the debtor exempted the property out of the bankruptcy estate. However, a tax lien that arises when a tax is assessed may not be removed from the property upon discharge if the property was excluded or abandoned from the bankruptcy estate, even if an NFTL was not filed.

Debt Cancellation

If a debt is canceled or forgiven, other than as a gift or bequest, the debtor must generally include the canceled amount in gross income for tax purposes. A debt includes any indebtedness for which the debtor is liable or that attaches to property the debtor holds. In the event that the amount forgiven is \$600 or more, the debtor should receive a Form 1099-C, Cancellation of Debt, from the lender. See Form 1099-C and its separate instructions. The debtor may not have to report the entire amount of canceled debt as income, as certain exclusions may apply.

Exclusions

Don't include a canceled debt in gross income if:

- The cancellation takes place in a bankruptcy case under the Bankruptcy Code;
- The cancellation takes place when the debtor is insolvent, and the amount excluded isn't more than the amount by which the debtor is insolvent;
- The canceled debt is qualified farm debt (debt incurred in operating a farm)—see *Cancellation of Debt* in chapter 3 of Pub. 225; or
- The canceled debt is qualified real property business indebtedness (certain debt connected with business real property). See Pub. 525.
- The canceled debt is qualified principal residence indebtedness. See Pub. 936, Home Mortgage Interest Deduction.

Order of exclusions. If the cancellation of debt occurs in a title 11 bankruptcy case, the bankruptcy exclusion takes precedence over

the insolvency exclusion. To the extent that the taxpayer is insolvent, the insolvency exclusion takes precedence over qualified farm debt or qualified real property business indebtedness exclusions.

Bankruptcy case exclusion. A bankruptcy case is a case under title 11 of the United States Code, but only if the debtor is under the jurisdiction of the court and the cancellation of the debt is granted by the court or occurs as a result of a plan approved by the court.

None of the debt canceled in a bankruptcy case is included in the debtor's gross income in the year it was canceled. Instead, certain losses, credits, and basis of property must be reduced by the amount of excluded income (but not below zero). These losses, credits, and basis in property are called tax attributes and are discussed under *Reduction of Tax Attributes*, later.

Insolvency exclusion. A debtor is insolvent when, and to the extent, the debtor's liabilities exceed the FMV of the assets.

Determine the debtor's liabilities and the FMV of the assets immediately before the cancellation of the debtor's debt to determine whether or not the debtor is insolvent and the amount by which the debtor is insolvent.

Exclude from the debtor's gross income debt canceled when the debtor is insolvent, but only up to the amount by which the debtor is insolvent. However, you must use the amount excluded to reduce certain tax attributes, as explained later under *Reduction of Tax Attributes*.

Example. \$4,000 of the Simpson Corporation's liabilities are canceled outside bankruptcy. Immediately before the cancellation, the Simpson Corporation's liabilities totaled \$21,000 and the FMV of its assets was \$17,500. Because its liabilities were more than its assets, it was insolvent.

The amount of the insolvency was \$3,500 (\$21,000 – \$17,500). The corporation may exclude only \$3,500 of the \$4,000 debt cancellation from income because that is the amount by which it was insolvent. It must also reduce certain tax attributes by the \$3,500 of excluded income. The remaining \$500 of canceled debt must be included in income.

Reduction of Tax Attributes

If a debtor excludes canceled debt from income because it is canceled in a bankruptcy case or during insolvency, they must use the excluded amount to reduce certain “tax attributes.” Tax attributes include the basis of certain assets and the losses and credits listed later. By reducing the tax attributes, the tax on the canceled debt is partially postponed instead of being entirely forgiven. This prevents an excessive tax benefit from the debt cancellation.

If a separate bankruptcy estate was created, the trustee or debtor-in-possession must reduce the estate's attributes (but not below zero) by the canceled debt. See *Attribute carryovers* under *Bankruptcy Estate—Income, Deductions, and Credits*, earlier.

Order of reduction. Generally, use the amount of canceled debt to reduce the tax attributes in the order listed below. However, the debtor may choose to use all or a part of the amount of canceled debt to first reduce the basis of depreciable property before reducing the other tax attributes. This choice is discussed later.

Net operating loss (NOL). Reduce any NOL for the tax year in which the debt cancellation takes place, and any NOL carryover to that tax year.

General business credit carryovers.

Reduce any carryovers, to or from the tax year of the debt cancellation, of amounts

used to determine the general business credit.

Minimum tax credit. Reduce any minimum tax credit that is available as of the beginning of the tax year following the tax year of the debt cancellation.

Capital losses. Reduce any net capital loss for the tax year of the debt cancellation, and any capital loss carryover to that year.

Basis. Reduce the basis of the debtor's property, as described under *Basis Reduction*, later. This reduction applies to the basis of both depreciable and nondepreciable property.

Passive activity loss and credit

carryovers. Reduce any passive activity loss or credit carryover from the tax year of the debt cancellation.

Foreign tax credit. Last, reduce any carryover, to or from the tax year of the debt cancellation, of an amount used to determine

the foreign tax credit or the Puerto Rico and possession tax credit.

Amount of reduction. Except for the credit carryovers, reduce the tax attributes listed earlier one dollar for each dollar of canceled debt that is excluded from income. Reduce the credit carryovers by $33\frac{1}{3}$ cents for each dollar of canceled debt that is excluded from income.

Making the reduction. Make the required reductions in tax attributes after figuring the tax for the tax year of the debt cancellation. In reducing NOLs and capital losses, first reduce the loss for the tax year of the debt cancellation, and then any loss carryovers to that year in the order of the tax years from which the carryovers arose, starting with the earliest year. Make the reductions of credit carryovers in the order in which the carryovers are taken into account for the tax year of the debt cancellation.

Individuals under chapter 7 or 11. In an individual bankruptcy under chapter 7 or 11 of title 11, the required reduction of tax attributes must be made to the attributes of the bankruptcy estate, a separate taxable entity resulting from the filing of the case. The trustee of the bankruptcy estate must make the choice of whether to reduce the basis of depreciable property first before reducing other tax attributes.

Basis Reduction

If any amount of the debt cancellation is used to reduce the basis of assets, as discussed earlier under *Reduction of Tax Attributes*, the following rules apply to the extent indicated.

When to make the basis reduction.

Reductions in basis due to debt cancellation are made at the beginning of the tax year following the cancellation. The reduction applies to property held at that time. See

Regulations section 1.1017-1 for more information.

Bankruptcy and insolvency reduction

limit. The reduction in basis for canceled debt in bankruptcy or in insolvency cannot be more than the total basis of property held immediately after the debt cancellation, minus the total liabilities immediately after the cancellation. This limit does not apply if an election is made to reduce basis before reducing other attributes. This election is discussed later.

Exempt property under title 11. If debt is canceled in a bankruptcy case under title 11 of the United States Code, don't reduce the basis in property that the debtor treats as exempt property under section 522 of title 11.

Election to reduce basis in depreciable property first. The estate, in the case of an individual bankruptcy under chapter 7 or 11, may choose to reduce the basis of depreciable

property before reducing any other tax attributes. However, this reduction of the basis of depreciable property cannot be more than the total basis of depreciable property held at the beginning of the tax year following the tax year of the debt cancellation.

Depreciable property means any property subject to depreciation, but only if a reduction of basis will reduce the amount of depreciation or amortization otherwise allowable for the period immediately following the basis reduction. The debtor may choose to treat as depreciable property any real property that is stock in trade or is held primarily for sale to customers in the ordinary course of trade or business. The debtor must generally make this choice on the tax return for the tax year of the debt cancellation, and, once made, the debtor can only revoke it with IRS approval. However, if the debtor establishes reasonable cause, the debtor may

make the choice with an amended return or claim for refund or credit.

Making elections. Make the election to reduce the basis of depreciable property before reducing other tax attributes, as well as the election to treat real property inventory as depreciable property, on Form 982.

Recapture of basis reductions. If any basis in property is reduced under these provisions and is later sold or otherwise disposed of at a gain, the part of the gain corresponding to the basis reduction is taxable as ordinary income. Figure the ordinary income part by treating the amount of the basis reduction as a depreciation deduction and by treating any such basis-reduced property that isn't already either Internal Revenue Code section 1245 or Internal Revenue Code section 1250 property as Internal Revenue Code section 1245 property. In the case of Internal Revenue Code section 1250 property, make the

determination of what would have been straight line depreciation as though there had been no basis reduction for debt cancellation. Internal Revenue Code sections 1245 and 1250 and the recapture of gain as ordinary income are explained in Pub. 544.

Partnerships

If a partnership's debt is canceled because of bankruptcy or insolvency, the rules for the exclusion of the canceled amount from gross income and for tax attribute reduction are applied at the individual partner level. Thus, each partner's share of debt cancellation income must be reported on the partner's return unless the partner meets the bankruptcy or insolvency exclusions explained earlier. Then all choices, such as the choices to reduce the basis of depreciable property before reducing other tax attributes, to treat real property inventory as depreciable property, and to end the tax year on the day before filing the bankruptcy case, must be

made by the individual partners, not the partnership.

Depreciable property. For purposes of reducing the basis of depreciable property in attribute reduction, a partner treats their partnership interest as depreciable property to the extent of the partner's proportionate interest in the partnership's depreciable property. This applies only if the partnership makes a corresponding reduction in the partnership's basis in its depreciable property with respect to the partner.

Partner's basis in partnership. The allocation of an amount of debt cancellation income to a partner results in that partner's basis in the partnership being increased by that amount. At the same time, the reduction in the partner's share of partnership liabilities caused by the debt cancellation results in a deemed distribution, in turn resulting in a reduction of the partner's basis in the partnership. These basis adjustments are

separate from any basis reduction under the attribute-reduction rules described earlier.

Corporations

Corporations in a bankruptcy proceeding or insolvency generally follow the same rules for debt cancellation and reduction of tax attributes as an individual or individual bankruptcy estate would follow.

Stock for Debt Exchange

If a corporation transfers its stock (or if a partnership transfers an interest in the partnership) in satisfaction of indebtedness and the FMV of the stock or interest is less than the indebtedness owed, the corporation or partnership has income to the extent of the difference from the cancellation of indebtedness. The corporation or partnership can exclude all or a portion of the income created by the stock or interest debt transfer if it is in a bankruptcy proceeding or, if not in a bankruptcy proceeding, it can exclude the

income to the extent it is insolvent. However, the corporation or partnership must reduce its tax attributes to the extent it has any by the amount of the excluded income.

Earnings and Profits

The earnings and profits of a corporation don't include income from the discharge of indebtedness to the extent of the amount applied to reduce the basis of the corporation's property, as explained earlier. Otherwise, discharge of indebtedness income, including amounts excluded from gross income, increases the earnings and profits of the corporation (or reduces a deficit in earnings and profits).

If there is a deficit in the corporation's earnings and profits and the interest of any shareholder of the corporation is terminated or extinguished in a title 11 or similar case (defined earlier), the deficit must be reduced by an amount equal to the paid-in capital

allocable to the shareholder's terminated or extinguished interest.

S Corporations

For S corporations, the rules for excluding income from debt cancellation because of bankruptcy or insolvency apply at the corporate level.

Net operating losses (NOLs). A loss or deduction that is disallowed for the tax year of the debt cancellation because it exceeds the shareholders' basis in the corporation's stock and debt is treated as an NOL for that tax year in making the required reduction of tax attributes for the amount of the canceled debt.

Example—Tax Attribute Reduction

Charlie Smith is in financial difficulty, but Charlie has been able to avoid declaring bankruptcy. In 2022, Charlie reached an

agreement with creditors whereby they agreed to forgive \$10,000 of the total Charlie owed to them in return for Charlie setting up a schedule for repayment of the rest of the debts.

Immediately before the debt cancellation, Charlie's liabilities totaled \$120,000 and the FMV of Charlie's assets was \$100,000 (Charlie's total basis in all these assets was \$90,000). At the time of the debt cancellation, Charlie was considered insolvent by \$20,000. Charlie can exclude from income the entire \$10,000 debt cancellation because it was not more than the amount by which Charlie was insolvent.

Among Charlie's assets, the only depreciable asset is a rental condominium with an adjusted basis of \$50,000. Of this, \$10,000 is allocable to the land, leaving a depreciable basis of \$40,000. Charlie has a long-term capital loss carryover to 2022 of \$5,000. Charlie also has an NOL of \$2,000 and a

\$3,000 NOL carryover from 2019. Charlie has no other tax attributes arising from the current tax year or carried to this year.

Ordinarily, in applying the \$10,000 debt cancellation amount to reduce tax attributes, Charlie would first reduce the \$2,000 NOL; next, the \$3,000 NOL carryover from 2019; and then the \$5,000 net capital loss carryover.

However, Charlie figures that it is better to preserve the loss carryovers for the next tax year.

Charlie elects to reduce basis first. Charlie can reduce the depreciable basis of the rental condominium (Charlie's only depreciable asset) by \$10,000. The tax effect of doing this will be to reduce depreciation deductions for years following the year of the debt cancellation. However, if Charlie later sells the condominium at a gain, the part of the gain from the basis reduction will be taxable as ordinary income.

Charlie must file Form 982 with the individual return (Form 1040 or 1040-SR) for the tax year of the debt discharge to reduce the depreciable basis of the property by \$10,000. In addition, Charlie must attach a statement describing the debt cancellation transaction and identifying the property to which the basis reduction applies.

How To Get Tax Help

If you have questions about a tax issue, need help preparing your tax return, or want to download free publications, forms, or instructions, go to [IRS.gov](https://www.irs.gov) and find resources that can help you right away.

Preparing and filing your tax return. After receiving all your wage and earnings statements (Form W-2, W-2G, 1099-R, 1099-MISC, 1099-NEC, etc.); unemployment compensation statements (by mail or in a digital format) or other government payment statements (Form 1099-G); and interest,

dividend, and retirement statements from banks and investment firms (Forms 1099), you have several options to choose from to prepare and file your tax return. You can prepare the tax return yourself, see if you qualify for free tax preparation, or hire a tax professional to prepare your return.

Free options for tax preparation. Go to [IRS.gov](https://www.irs.gov) to see your options for preparing and filing your return online or in your local community, if you qualify, which include the following.

- **Free File.** This program lets you prepare and file your federal individual income tax return for free using brand-name tax-preparation-and-filing software or Free File fillable forms. However, state tax preparation may not be available through Free File. Go to [IRS.gov/ FreeFile](https://www.irs.gov/FreeFile) to see if you qualify for free online federal tax

preparation, e-filing, and direct deposit or payment options.

- **VITA.** The Volunteer Income Tax Assistance (VITA) program offers free tax help to people with low-to-moderate incomes, persons with disabilities, and limited-English-speaking taxpayers who need help preparing their own tax returns. Go to [IRS.gov/ VITA](https://www.irs.gov/VITA), download the free IRS2Go app, or call 800-906-9887 for information on free tax return preparation.
- **TCE.** The Tax Counseling for the Elderly (TCE) program offers free tax help for all taxpayers, particularly those who are 60 years of age and older. TCE volunteers specialize in answering questions about pensions and retirement-related issues unique to seniors. Go to [IRS.gov/TCE](https://www.irs.gov/TCE), download the free IRS2Go app, or call

888-227-7669 for information on free tax return preparation.

- **MilTax.** Members of the U.S. Armed Forces and qualified veterans may use MilTax, a free tax service offered by the Department of Defense through Military OneSource. For more information go to [MilitaryOneSource \(MilitaryOneSource.mil/MilTax\)](https://MilitaryOneSource.mil/MilTax).

Also, the IRS offers Free Fillable Forms, which can be completed online and then filed electronically regardless of income.

Using online tools to help prepare your return. Go to IRS.gov/Tools for the following.

- The [Earned Income Tax Credit Assistant \(IRS.gov/ EITCAssistant\)](https://IRS.gov/EITCAssistant) determines if you're eligible for the earned income credit (EIC).
- The [Online EIN Application \(IRS.gov/EIN\)](https://IRS.gov/EIN) helps you get an

employer identification number (EIN) at no cost.

- The [*Tax Withholding Estimator*](#) ([*IRS.gov/W4app*](#)) makes it easier for you to estimate the federal income tax you want your employer to withhold from your paycheck. This is tax withholding. See how your withholding affects your refund, take-home pay, or tax due.
- The [*First Time Homebuyer Credit Account Look-up*](#) ([*IRS.gov/HomeBuyer*](#)) tool provides information on your repayments and account balance.
- The [*Sales Tax Deduction Calculator*](#) ([*IRS.gov/ SalesTax*](#)) figures the amount you can claim if you itemize deductions on Schedule A (Form 1040).



Getting answers to your tax questions. On IRS.gov, you can get up-to-date information on current events and changes in tax law.

- [IRS.gov/Help](https://www.irs.gov/help): A variety of tools to help you get answers to some of the most common tax questions.
- [IRS.gov/ITA](https://www.irs.gov/ita): The Interactive Tax Assistant, a tool that will ask you questions and, based on your input, provide answers on a number of tax law topics.
- [IRS.gov/Forms](https://www.irs.gov/forms): Find forms, instructions, and publications. You will find details on the most recent tax changes and interactive links to help you find answers to your questions.
- You may also be able to access tax law information in your electronic filing software.

Need someone to prepare your tax return? There are various types of tax return preparers, including tax preparers, enrolled agents, certified public accountants (CPAs), attorneys, and many others who don't have professional credentials. If you choose to have someone prepare your tax return, choose that preparer wisely. A paid tax preparer is:

- Primarily responsible for the overall substantive accuracy of your return,
- Required to sign the return, and
- Required to include their preparer tax identification number (PTIN).

Although the tax preparer always signs the return, you're ultimately responsible for providing all the information required for the preparer to accurately prepare your return. Anyone paid to prepare tax returns for others should have a thorough understanding of tax matters. For more information on how to

choose a tax preparer, go to [*Tips for Choosing a Tax Preparer*](#) on IRS.gov.

Coronavirus. Go to [*IRS.gov/Coronavirus*](#) for links to information on the impact of the coronavirus, as well as tax relief available for individuals and families, small and large businesses, and tax-exempt organizations.

Employers can register to use Business Services Online. The Social Security Administration (SSA) offers online service at [*SSA.gov/employer*](#) for fast, free, and secure online W-2 filing options to CPAs, accountants, enrolled agents, and individuals who process Form W-2, Wage and Tax Statement, and Form W-2c, Corrected Wage and Tax Statement.

IRS social media. Go to [*IRS.gov/SocialMedia*](#) to see the various social media tools the IRS uses to share the latest information on tax changes, scam alerts, initiatives, products, and services. At the IRS, privacy and security are paramount. We use

these tools to share public information with you. **Don't** post your SSN or other confidential information on social media sites. Always protect your identity when using any social networking site.

The following IRS YouTube channels provide short, informative videos on various tax-related topics in English, Spanish, and ASL.

- [Youtube.com/irsvideos](https://www.youtube.com/irsvideos).
- [Youtube.com/irsvideomultilingua](https://www.youtube.com/irsvideomultilingua).
- [Youtube.com/irsvideosASL](https://www.youtube.com/irsvideosASL).

Watching IRS videos. The IRS Video portal [IRSVideos.gov](https://www.irs.gov/irs/videos) contains video and audio presentations for individuals, small businesses, and tax professionals.

Online tax information in other languages. You can find information on [IRS.gov/MyLanguage](https://www.irs.gov/MyLanguage) if English isn't your native language.

Free Over-the-Phone Interpreter (OPI) service. The IRS is committed to serving our multilingual customers by offering OPI services. The OPI service is a federally funded program and is available at Taxpayer Assistance Centers (TACs), other IRS offices, and every VITA/TCE return site. OPI service is accessible in more than 350 languages.

Accessibility Helpline available for taxpayers with disabilities. Taxpayers who need information about accessibility services can call 833-690-0598. The Accessibility Helpline can answer questions related to current and future accessibility products and services available in alternative media formats (for example, braille, large print, audio, etc.).

Note. Form 9000, Alternative Media Preference, or Form 9000(SP) allows you to elect to receive certain types of written correspondence in the following formats.

- Standard Print.
- Large Print.
- Braille.
- Audio (MP3).
- Plain Text File (TXT).
- Braille Ready File (BRF).

Disasters. Go to [Disaster Assistance and Emergency Relief for Individuals and Businesses](#) to review the available disaster tax relief.

Getting tax forms and publications. Go to [IRS.gov/ Forms](#) to view, download, or print all of the forms, instructions, and publications you may need. Or you can go to [IRS.gov/OrderForms](#) to place an order.

Getting tax publications and instructions in eBook format. You can also download and view popular tax publications and instructions (including the Instructions for Forms 1040) on

mobile devices as an eBook at [IRS.gov/eBooks](https://www.irs.gov/eBooks).

Note. IRS eBooks have been tested using Apple's iBooks for iPad. Our eBooks haven't been tested on other dedicated eBook readers, and eBook functionality may not operate as intended.

Access your online account (Individual taxpayers only). Go to [IRS.gov/Account](https://www.irs.gov/Account) to securely access information about your federal tax account.

- View the amount you owe and a breakdown by tax year.
- See payment plan details or apply for a new payment plan.
- Make a payment or view 5 years of payment history and any pending or scheduled payments.

- Access your tax records, including key data from your most recent tax return, your EIP amounts, and transcripts.
- View digital copies of select notices from the IRS.
- Approve or reject authorization requests from tax professionals.
- View your address on file or manage your communication preferences.

Tax Pro Account. This tool lets your tax professional submit an authorization request to access your individual taxpayer [IRS online account](#). For more information, go to [IRS.gov/TaxProAccount](#).

Using direct deposit. The fastest way to receive a tax refund is to file electronically and choose direct deposit, which securely and electronically transfers your refund directly into your financial account. Direct deposit also avoids the possibility that your check could be lost, stolen, or returned undeliverable to the

IRS. Eight in 10 taxpayers use direct deposit to receive their refunds. If you don't have a bank account, go to [IRS.gov/DirectDeposit](https://www.irs.gov/directdeposit) for more information on where to find a bank or credit union that can open an account online.

Getting a transcript of your return. The quickest way to get a copy of your tax transcript is to go to [IRS.gov/Transcripts](https://www.irs.gov/transcripts). Click on either "Get Transcript Online" or "Get Transcript by Mail" to order a free copy of your transcript. If you prefer, you can order your transcript by calling 800-908-9946.

Reporting and resolving your tax-related identity theft issues.

- Tax-related identity theft happens when someone steals your personal information to commit tax fraud. Your taxes can be affected if your SSN is used to file a fraudulent return or to claim a refund or credit.

- The IRS doesn't initiate contact with taxpayers by email, text messages (including shortened links), telephone calls, or social media channels to request or verify personal or financial information. This includes requests for personal identification numbers (PINs), passwords, or similar information for credit cards, banks, or other financial accounts.
- Go to [IRS.gov/IdentityTheft](https://www.irs.gov/IdentityTheft), the IRS Identity Theft Central webpage, for information on identity theft and data security protection for taxpayers, tax professionals, and businesses. If your SSN has been lost or stolen or you suspect you're a victim of tax-related identity theft, you can learn what steps you should take.
- Get an Identity Protection PIN (IP PIN). IP PINs are six-digit numbers assigned to taxpayers to help prevent

the misuse of their SSNs on fraudulent federal income tax returns. When you have an IP PIN, it prevents someone else from filing a tax return with your SSN. To learn more, go to [IRS.gov/IPPIN](https://www.irs.gov/IPPIN).

Ways to check on the status of your refund.

- Go to [IRS.gov/Refunds](https://www.irs.gov/Refunds).
- Download the official IRS2Go app to your mobile device to check your refund status.
- Call the automated refund hotline at 800-829-1954.

Note. The IRS can't issue refunds before mid-February 2023 for returns that claimed EIC or the additional child tax credit (ACTC). This applies to the entire refund, not just the portion associated with these credits.

Making a tax payment. Go to [IRS.gov/Payments](https://www.irs.gov/Payments) to make a payment using any of the following options.

- [IRS Direct Pay](#): Pay your individual tax bill or estimated tax payment directly from your checking or savings account at no cost to you.
- [Debit or Credit Card](#): Choose an approved payment processor to pay online or by phone.
- [Electronic Funds Withdrawal](#): Schedule a payment when filing your federal taxes using tax return preparation software or through a tax professional.
- [Electronic Federal Tax Payment System](#): Best option for businesses. Enrollment is required.
- [Check or Money Order](#): Mail your payment to the address listed on the notice or instructions.

- [Cash](#): You may be able to pay your taxes with cash at a participating retail store.
- [Same-Day Wire](#): You may be able to do same-day wire from your financial institution. Contact your financial institution for availability, cost, and cut-off times.

Note. The IRS uses the latest encryption technology to ensure that the electronic payments you make online, by phone, or from a mobile device using the IRS2GO app are safe and secure. Paying electronically is quick, easy, and faster than mailing in a check or money order.

What if I can't pay now? Go to [IRS.gov/Payments](https://www.irs.gov/Payments) for more information about your options.

- Apply for an [online payment agreement](#) ([IRS.gov/ OPA](https://www.irs.gov/OPA)) to meet your tax obligation in monthly

installments if you can't pay your taxes in full today. Once you complete the online process, you will receive immediate notification of whether your agreement has been approved.

- Use the [Offer in Compromise Pre-Qualifier](#) to see if you can settle your tax debt for less than the full amount you owe. For more information on the Offer in Compromise program, go to [IRS.gov/OIC](#).

Filing an amended return. Go to [IRS.gov/Form1040X](#) for information and updates.

Checking the status of an amended return. Go to [IRS.gov/WMAR](#) to track the status of Form 1040-X amended returns.

Note. It can take up to 3 weeks from the date you filed your amended return for it to show up in our system, and processing it can take up to 16 weeks.

Understanding an IRS notice or letter you've received. Go to [IRS.gov/Notices](https://www.irs.gov/Notices) to find additional information about responding to an IRS notice or letter.

Note. You can use Schedule LEP (Form 1040), Request for Change in Language Preference, to state a preference to receive notices, letters, or other written communications from the IRS in an alternative language. You may not immediately receive written communications in the requested language. The IRS's commitment to LEP taxpayers is part of a multi-year timeline that is scheduled to begin providing translations in 2023. You will continue to receive communications, including notices and letters, in English until they are translated to your preferred language.

Contacting your local IRS office. Keep in mind, many questions can be answered on IRS.gov without visiting an IRS TAC. Go to [IRS.gov/LetUsHelp](https://www.irs.gov/LetUsHelp) for the topics people ask

about most. If you still need help, IRS TACs provide tax help when a tax issue can't be handled online or by phone. All TACs now provide service by appointment, so you'll know in advance that you can get the service you need without long wait times. Before you visit, go to [IRS.gov/TACLocator](https://www.irs.gov/TACLocator) to find the nearest TAC, check hours, available services, and appointment options. Or, on the IRS2Go app, under the Stay Connected tab, choose the Contact Us option and click on "Local Offices."

The Taxpayer Advocate Service (TAS) Is Here To Help You What is TAS?

TAS is an ***independent*** organization within the IRS that helps taxpayers and protects taxpayer rights. Their job is to ensure that every taxpayer is treated fairly and that you know and understand your rights under the [Taxpayer Bill of Rights](#).

How Can You Learn About Your Taxpayer Rights?

The Taxpayer Bill of Rights describes 10 basic rights that all taxpayers have when dealing with the IRS. Go to [TaxpayerAdvocate.IRS.gov](https://www.irs.gov/taxpayeradvocate) to help you understand what these rights mean to you and how they apply. These are ***your*** rights. Know them. Use them.

What Can TAS Do For You?

TAS can help you resolve problems that you can't resolve with the IRS. And their service is free. If you qualify for our assistance, you will be assigned to one advocate who will work with you throughout the process and will do everything possible to resolve your issue. TAS can help you if:

- Your problem is causing financial difficulty for you, your family, or your business,

- You face (or your business is facing) an immediate threat of adverse action, or
- You've tried repeatedly to contact the IRS but no one has responded, or the IRS hasn't responded by the date promised.

How Can You Reach TAS?

TAS has offices [*in every state, the District of Columbia, and Puerto Rico*](#). Your local advocate's number is in your local directory and at [*TaxpayerAdvocate.IRS.gov/ Contact-Us*](https://TaxpayerAdvocate.IRS.gov/Contact-Us). You can also call us at 877-777-4778.

How Else Does TAS Help Taxpayers?

TAS works to resolve large-scale problems that affect many taxpayers. If you know of one of these broad issues, please report it to us at [*IRS.gov/SAMS*](https://IRS.gov/SAMS).

TAS for Tax Professionals

TAS can provide a variety of information for tax professionals, including tax law updates and guidance, TAS programs, and ways to let TAS know about systemic problems you've seen in your practice.

Low Income Taxpayer Clinics (LITCs)

LITCs are independent from the IRS. LITCs represent individuals whose income is below a certain level and need to resolve tax problems with the IRS, such as audits, appeals, and tax collection disputes. 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 eligible taxpayers. To find an LTC near you, go to

TaxpayerAdvocate.IRS.gov/about-us/LowIncome-Taxpayer-Clinics-LITC/ or see

IRS Pub. 4134, [Low Income Taxpayer Clinic List.](#)

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To help us develop a more useful index, please let us know if you have ideas for index entries. See “Comments and Suggestions” in the “Introduction” for the ways you can reach us.

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