

Cancellation of Debt (Edited transcript)

Male #1: Good afternoon. Welcome to the 2008 IRS Nationwide Tax Forums. My name is Howvard Brooks. I'm with the Taxpayer Advocate Service Organization and you're currently attending the Cancellation of Debt seminar.

Today it is my pleasure to introduce Matt Weir from the Taxpayer Advocate Service. Before coming to the IRS Matt spent 15 years as an attorney and as a CPA. He joined the IRS as an attorney advisor to the National Taxpayer Advocate. He is currently serving as the director of advocacy projects. Mr. Matt Weir.

Matt: Thank you Howvard. Today we are privileged to have a distinguished group of tax experts to discuss an important piece of the tax code puzzle, cancellation of debt income, or as we slip into acronym speak, COD income, a topic which particularly needs our attention today in light of the mortgage crisis facing our country. Shortly we will hear a pod cast from the National Taxpayer Advocate on this subject. But first I would like to introduce our panel and briefly explain what each will be discussing with you today. To my right Fran Mucciolo, he's with Counsel from the Small Business and Self-Employed Division of the IRS. Fran will be discussing the technical aspects of COD income. To Fran's right we have Anne Freeman who is with Systemic Advocacy in the Taxpayer Advocate Service. Anne was instrumental in putting together the new Publication 4681 on cancellation of debt income. And to Anne's right is Curtis Raven from a low-income taxpayer clinic. He is going to be discussing with you the taxpayer and the tax practitioner perspective. And to Curtis' right, Maria Anderson from the IRS' Automated Under Reporter unit.

First we're going to watch Nina Olson in her podcast discussing this topic.

Female #1: This message from the National Taxpayer Advocate is intended for individual taxpayers.

Nina: Hello, I'm Nina Olson, the National Taxpayer Advocate, here to talk to you about cancellation of debt income. This issue affected over two million taxpayers in 2007 and we expect it will impact many more this year because of the sub prime mortgage situation. So what is cancellation of debt income? Well, it's a little

counterintuitive but let me try to explain. When you borrow money, say, to buy a home or on a credit card, you don't have to report those funds as income to the IRS because you have agreed to pay back the loan. If, after a while, you can't pay that loan back and the lender forgives your debt, you have received a benefit. Under the U.S. tax laws, that benefit may be taxable income. If you have been forgiven a debt, for instance if your mortgage has been foreclosed or a credit card balance has been written off, you may receive a Form 1099C, similar to the forms 1099 you might receive from your bank.

The first thing to remember is that you need to report this income on your tax return. The second thing to remember is that this income may or may not be taxable to you. You may be able to exclude some or all of it from your income. To claim an exclusion you generally must file Form 982 along with your return.

The tax treatment of cancellation of debt income is very complex. You may exclude cancellation of debt income in five main situations.

First, mortgage loans. Some taxpayers have lost their homes to foreclosure at a time when the remaining balance of the loan was greater than the value of the house. For example, if your loan balance is \$125,000 and the value of your house is \$100,000 at the time of foreclosure, you ordinarily would have to report \$25,000 of cancellation of debt income if the lender agrees to write off that debt. If your mortgage debt though is cancelled in 2007, 2008 or 2009 you generally may exclude the cancelled amount from income up to certain dollar limits. Similar rules apply where the principle balance of a loan is reduced through a workout ever where you get to keep your home.

The second exclusion is insolvency. The word "insolvent" means the sum total of your liabilities, that is your debts, is greater than the sum total of your assets. When you are insolvent, cancellation of debt income generally is not taxable to the extent of your insolvency. So, for example, if a credit card company forgives a debt of \$5,000 and your liabilities exceed your assets by \$3,000, you may exclude that \$3,000 from gross income. And you'll only need to include that remaining balance of \$2,000 in your gross income. If you were insolvent by \$5,000 or more, you would be entitled to exclude the full amount of the \$5,000 of cancelled debt from gross income. Insolvency is measured as immediately before the moment when the lender cancelled your debt.

Bankruptcy. If your debt is discharged in bankruptcy, you generally do not have taxable income from cancellation of debt.

Qualified Farm Debt. Cancelled debt is generally not taxable income if the debt in question was incurred directly in the operation of a farm, as long as certain other requirements are met.

And the last exclusion is for nonrecourse loans. Nonrecourse loans allow the lender to recover the debt only by repossessing the property securing the loan, not by pursuing the borrower's other assets. When nonrecourse loans are cancelled, no cancellation of debt income arises so long as the lender takes back the property.

Now remember, if you receive a Form 1099C, you must first report the income on your tax return. If you qualify to exclude that income, you should also file Form 982 with your return. You can get a copy of Form 982 from www.irs.gov or visit your local IRS Taxpayer Assistance Center.

The tax treatment of cancellation of debt income is very complex. There are a variety of IRS publications that may be able to help you or you might consider seeking professional help when faced with potential cancellation of debt income, including the use of a low-income taxpayer clinic. For more information on these clinics, please visit www.irs.gov/advocate and click on the link for low-income taxpayer clinics. If you are facing economic harm because of your cancellation of debt issue, call the Taxpayer Advocate Service at 1-877-ASK-TAS1.

Female #1: For more information contact the Taxpayer Advocate Service by calling 1-877-ASK-TAS1, or visit www.irs.gov/advocate.

Fran: Now it's my turn. As Matt has said, I'm Fran Mucciolo. I'm an attorney with the Office of Chief Counsel and our office in North Florida is in Jacksonville. Well, we'll get right to it, addressing cancellation of debt. The first thing you should know about cancellation of debt is the general rule. Internal Revenue Code section 61(a)(12) provides that gross income includes income from the discharge of indebtedness. Let me give an example of that. Taxpayer A borrows \$10,000 from Bank X in 2006. When the loan comes due in 2007, Taxpayer A is able to repay only \$8,000. Bank X discharges the remaining \$2,000. Taxpayer A has \$2,000 of cancellation of debt income. That's pretty straightforward.

Another section of the Internal Revenue Code, 6050 cap P, requires certain financial institutions and federal agencies that

cancel a debt of \$600 or more during any calendar year to file an information return with the Internal Revenue Service and provide a copy to the taxpayer whose debt was cancelled. That information return is Form 1099C.

Cancellation of debt income can arise in various contexts, including cancellation of credit card debt, automobile debt, student loan debt, and what we're most interested in today, home mortgage debt.

Let's discuss non-recourse debt for a moment. First of all, what is it? It's a debt for which the borrower is not personally liable. What happens when it is cancelled? When non-recourse debt is cancelled by reason of the disposition of property, no cancellation of debt income is realized. Instead the full amount of the debt is included in the amount realized on the disposition.

However in a workout, cancellation of debt income can arise. We've cited to you Revenue Ruling 91-31 and I'm going to give you an example. In 1988, Individual A borrowed one million dollars from C and signed a note payable to C for one million dollars that bore interest at a fixed market rate payable annually. A had no personal liability with respect to the note which was secured by an office building valued at one million dollars that A acquired from B with the proceeds of the non-recourse financing. In 1989 when the value of the office building was \$800,000 and the outstanding balance on the note was one million dollars, C agreed to modify the terms of the note by reducing the note's principal amount to \$800,000. Now C would do that in the case of non-recourse financing because C doesn't want the building, C wants to get paid and if the debt remains at a million dollars then A is just going to walk away from the debt. So C agrees to reduce the debt by 200,000 to 800,000.

What's the tax effect of that? This is the workout. The reduction of the principal amount of an under-secured non-recourse debt by the holder of the debt who is not the seller of the property securing the debt, results in the realization of discharge of indebtedness income under the general rule in IRC section 61(a)(12).

There may be gain or loss on disposition of property for which you're indebted. If the debt for which the taxpayer is personally liable is discharged as a result of foreclosure, a sale, or other disposition of property that secures the debt, the taxpayer may realize gain or loss on the disposition as well as cancellation of debt income. In the case of personal use property such as a

principal residence, any loss would be non-deductible. That's the main point you should take away from this segment of the presentation that the loss on the disposition of personal residence or principal residence is non-deductible.

IRC section 108(e)(2) provides that no cancellation of debt income is realized to the extent that payment of the debt would have given rise to a deduction.

Mortgage interest is generally deductible under section 163(h)(3); so forgiveness of that indebtedness will not give rise to cancellation of debt income. On the other hand, interest on other types of consumer debt, for example credit card debt, automobile financing, and the like, generally is non-deductible personal interest under section 163(h)(2) and will give rise to cancellation of debt income.

Now back to the workouts. Cancellation of debt income can arise in a debt workout as well as a foreclosure as we discussed a little while ago when I went over that revenue ruling with you. Whether this cancellation of debt income is taxable depends on whether an exception in section 108 applies. Section 108 is an exclusion section of the Internal Revenue Code. Section 61(a)(12) defines the cancellation of debt income as taxable, but then Section 108 may apply to exclude it.

And that happens when the discharge occurs in bankruptcy. It also happens when the discharge occurs when the taxpayer is insolvent. It happens when the debt is qualified farm indebtedness and I think there's a lot of that in Central Florida here which is the fern capital of the world. It happens when the debt is a student loan for which the exclusion provision of section 108(f) applies and also when the debt is qualified principal residence indebtedness which we're most interested in today.

In 2007, the Congress passed and the President signed into law the Mortgage Forgiveness Debt Relief Act. That act created a new exclusion under sections 108(a)(1)(E) and 108(h) for discharged qualified principal residence indebtedness. We'll go through a definition of that in a moment. The section applies to qualified principal residence indebtedness that is discharged on or after January 1 of 2007, and before January 1, 2010. And my guess is that there will be some extension of that act close to the expiration date.

Alright. What is qualified principal residence indebtedness? First of all it's acquisition indebtedness and that term is defined in section 163(h)(3) capital B. For a principal residence, acquisition indebtedness is debt incurred in acquiring, constructing, or substantially improving the home and secured by the home. It may include refinanced debt and the proceeds of a home equity loan used to substantially improve the home. Principal residence is defined in section 121 of the Internal Revenue Code.

The five year look-back test of Section 121 is not part of the definition of principal residence. And unfortunately there's only a two million dollar limitation on this. This concludes my presentation of the technical side of cancellation of debt and I'm now going to turn over the mic to Anne Freeman.

Anne:

Good afternoon. My name is Anne Freeman. I'm with the Taxpayer Advocate Service and I'm going to talk to you about the application of that law, in other words, how do you complete the tax return for your client so that later down the road they're not receiving a notice from the IRS telling them that they failed to report cancellation of indebtedness income when in fact they are entitled to an exclusion under section 108. I have a word of warning and I also have a disclaimer. My word of warning is that while I find this topic to be extremely exciting, some of you in the audience may not share that.

In fact I met a woman at the airport who is staying at this hotel and said "Oh great, she must be coming to the tax forums. I'm going to get her to attend my seminar." And she said "Oh, no, no. I'm not going to that conference. I'm going to a different conference." I said "Well, you're a taxpayer. You should know about the tax law. It's an important topic. It's affecting a lot of people. You could come to this presentation anyway. I'm going to talk about the tax consequences of cancellation of indebtedness income." And she turned to me and she looked at me like I had three heads and she goes "No, I think I'd rather go to my wastewater management session." So I think that kind of speaks for itself.

My disclaimer is that this topic can get very complicated very quickly. There's a lot of nuances. This presentation here is not intended to get in to all of those nuances, but instead is aimed to be a general overview so that when a client comes in and has a 1099A or 1099C you're going to be aware of some of the issues. You're going to know some of the questions to ask and you're going to know where to go for a reference.

The first place I'm going to steer you to for guidance is this publication 4681. This provides a lot of good detailed examples and goes through all the exclusions and exceptions in pretty fine detail so it is a very good point of reference. It is available on irs.gov. I'm also told that this is a very good sleeping aid so if you're having trouble sleeping you may want to get that as well.

So where do you start? Okay, the first thing you're going to know is that somebody is going to walk in to your office and they're going to have a 1099A or a 1099C and it's very important to know what the difference is between those two forms. The Form 1099A is used when a lender acquires an interest in property that is securing the debt or knows or has reason to know that the property has been abandoned. So essentially the 1099A is used for foreclosures, repossessions, and abandonments. What those three things should tell you is that that taxpayer has a disposition of the property.

All three of those are treated for tax purposes as a disposition of property. Therefore you need to calculate any gain or loss that that taxpayer has. You need to figure out what the character of any gain or loss is, whether it's ordinary, whether it's capital, and you also have to figure out if there is a loss whether it's a deductible or non-deductible loss. Probably the majority of losses will be non-deductible as they will be personal in nature.

The 1099C is issued when the lender actually cancels the debt without taking anything in value. And the 1099C, what that should equate to you is that this taxpayer now has ordinary income from the cancellation of debt. As a general rule that's going to be fully taxable and will be reported on the return. We will get into the exceptions and the exclusions later. There's also an interaction between the two forms, the 1099A and the 1099C and basically if the lender has to issue both a 1099A and a 1099C to the same debtor, on the same debt, in the same calendar year, their reporting requirements will be satisfied through the issuance of a 1099C only.

So a taxpayer might walk in to your office with a 1099C and not only should you be thinking this is ordinary income from the cancellation of debt, but you may also have to calculate whether there's a gain or a loss from the disposition. The way that you're going to know that there's a disposition is fair market value of the property will be shown in box seven, you'll also know because you'll question your client about – you know, tell me the facts and circumstances of this issue.

The fair market value is something that you'll want to pay particular attention to because sometimes what's written in the fair market value may not truly represent what the true fair market value is. And so one of the questions you should be asking is how did the lender determine what the fair market value of the property was? Was it based on the sale to a third party? Was it based on an appraisal? Does your client have information which shows that the true fair market value is actually different? And the reason why this is of particular importance is because fair market value will be used to determine both how much COD income the taxpayer has but also how much of a gain or a loss they may have.

In some instances you may want a higher fair market value because a higher fair market value will lower your COD income. So if the taxpayer is in a gain situation but is unable to exclude COD income under one of these provisions, maybe you can change that to a capital gain. Now you also might have the flipside. If the taxpayer is able to exclude COD income under one of the provisions of 108 you may want to decrease the fair market value which would increase the COD income. So again just pay particular attention to that, find out the details, question your client, question the lender. Next year's 1099C will have the lender's telephone number which was actually a recommendation made by the National Taxpayer Advocate in her Annual Report to Congress. So you'll see that next year. It will be easier for you to contact the lender.

So moving on to the general rule. COD is taxable as ordinary income and where it gets reported on the return is going to be determined by the nature of the underlying debt. If it's non-business debt you're going to report it on Form 1040 line 21. If it's business debt you're going to put it on the related business schedule. One thing that you should note is what gets put on the return is the net taxable amount. It is not the full COD income. So if you're able to exclude, you're going to write down the amount of the exclusion using Form 982 and you're going to put the net amount on these various lines depending on what type of underlying debt it is.

So what are the exceptions and the exclusions? I'm going to go through these very quickly. I'm going to focus in on three of them. The exceptions include amounts that are otherwise excludable from income so if the cancellation was intended as a gift it doesn't result in COD income.

Certain student loans which was mentioned before, deductible debt, also mentioned before. If price was reduced at the purchase it will generally reduce the basis of the underlying asset as opposed to resulting in COD income. The exclusions are, and all of these exclusions are noted on the 982. This is how you're going to show that you're excluding debt under one of these provisions.

Bankruptcy, insolvency, qualified farm indebtedness, qualified real property business indebtedness, qualified principal residence indebtedness. As I said I'm going to focus on the three most common, bankruptcy, insolvency, qualified principal residence indebtedness.

For bankruptcy, very straightforward. If the debt was discharged in a Title 11 bankruptcy case it is excludable from income. You're going to check box 1A on Form 982. You're going to exclude the amount discharged, and only if you have other debt that is not discharged in the bankruptcy would there be any kind of net amount possibly on the Form 1040.

Under the insolvency we start getting into a little bit more of the complication. The insolvency is claimed by checking line 1B, the box on line 1B of Form 982, but there's a limit here which says that the amount excluded cannot be greater than the extent to which the taxpayer is insolvent immediately before the discharge.

So how do you calculate insolvency? The taxpayer's total liabilities, minus the fair market value of their total assets, both of those measured immediately before the discharge. Sounds easy enough right? Until your client comes in and says "Oh I had this debt discharged on May 12th." And you're saying "Okay, well tell me what the fair market value of all your assets were immediately before that debt was discharged and all the liabilities." Your client is going to look at you like "What are you talking about? I don't own anything."

Well assets include all of your assets. It includes value in IRA account; it includes interest in a pension plan. It is your total assets regardless of whether those assets can generally be reached by creditors. Your liabilities. You're probably going to have to probe. Does the taxpayer have accrued liabilities that they're not thinking of, accrued real property taxes, etc.? So this is going to be something that you're going to have to tell your client "You need to bring me the information. You've got to show me so that I can calculate the extent to which you are insolvent."

The third exclusion that I'm focusing in on is the qualified principle residence indebtedness. And here this is covered a little bit earlier, the maximum amount you can treat as qualified principle residence indebtedness is two million dollars. Its one million if you're married filing separately. Again, it must be the qualified acquisition indebtedness. Then comes in this ordering rule which says "If only a part of the loan is qualified principle residence indebtedness the exclusion for discharge of qualified principle residence indebtedness applies only to the extent the amount discharged exceeds the amount of the loan immediately before the discharge that was not qualified principle residence indebtedness.

So what does that tell you? That tells you that somebody needs to take an English course, that's what it tells me. Because I don't know what that's supposed to mean. But in all practicality the ordering rule is somewhat straightforward and it basically tells you that if any part of the loan that is discharged under the qualified principal residence indebtedness - if any part of that debt was used for non-qualified purposes, that needs to come out first. So it's important to note that this is on a loan by loan basis.

This example that I'm showing has an outstanding mortgage balance of \$750,000. It was refinanced for \$850,000 and the taxpayer used the additional \$100,000 for non-qualified purposes. The lender forecloses, sells the property, and cancels the remaining portion of the debt. So they have \$115,000 of debt cancelled. The first thing that you need to know is was any portion of that loan used for non-qualified purposes? And if so that gets backed out first. So in this example the maximum amount that can be used for the qualified principal residence indebtedness exclusion is \$15,000. For the \$100,000 of non-qualified debt, you need to find another exclusion or it's going to be taxable.

What's important to note here is that you may have a home equity line of credit situation where you have two separate and distinct loans. So you're going to look at which of the loans were discharged and was any part of that loan used for non-qualified purposes. So if you have a home equity line of credit that was used for non-qualified purposes but the debt that was cancelled was on the original mortgage and all of that was used for qualified acquisition indebtedness then the ordering rule doesn't come into play because you still have that outstanding debt relating to the non-qualified home equity line.

So there's an old saying that nothing is easy and nothing is free, and you've seen that this is certainly not an easy topic and now you're going to find out that nothing is free because if your client excludes income from the discharge of cancellation of debt then what they also have to do is they have to reduce any tax attributes that they may have. Now it's important to know your client does not have to have any tax attributes, okay? That doesn't affect their ability to exclude the income. But if they exclude and they do have tax attributes, that's when this rule comes into play. And the reduction of tax attributes gets done after you calculate the tax liability for the year. So essentially you're giving the taxpayer one last stab at using any of these benefits and whatever's left over, if they're excluding income you've got to start reducing and generally it's going to be done in the order that's listed.

For qualified principal residence indebtedness the rule is that it first gets applied only to reduce the basis of the house. So if the house was foreclosed upon or abandoned and the taxpayer no longer owns that house, they have no basis to reduce. They can exclude under the qualified principal residence indebtedness exclusion and not have any related basis reduction.

I'm going to cover an example that's in this Pub 4681. I'm going to cover it very, very quickly. If you turn to page 15 you'll see that this is a pretty complicated example and I'm going to boil it down to about two minutes for you. Essentially Frank and Kathy Willow entered into a contract to build their principal residence for three million dollars. They put down \$400,000 and used a \$2.6 million dollar mortgage. It was a recourse loan so the non-recourse aspect doesn't come in to play. When the outstanding balance on the mortgage loan was two and a half million dollars the fair market value of the property fell and Kathy and Frank abandoned the property. The lender foreclosed and sold the property for \$1,750,000.

Later that year they cancelled the remaining \$750,000 on the debt. Essentially the first thing you need to think about is, okay, what happened first? The foreclosure occurred first. There was no cancellation of indebtedness at the time of foreclosure. The cancellation of indebtedness actually occurred later. It may occur later in that tax year, it may occur in another tax year. So the first thing you want to do is calculate your gain or loss on the foreclosure and they would do so using table 1.1 on page 16 and you'll notice that they have zero ordinary income from the cancellation of indebtedness at that time. That is at that time. That doesn't mean that later they don't have it. They find that they have

a loss which is a non-deductible loss and then they go through the various rules on exclusion and they'll use the – they have to use the ordering rule because the debt actually exceeded the two million dollar limitation which makes part of that loan non-qualified because of the two million dollar limit.

So the ordering rule comes in to play in this example and the insolvency rule comes in to play because they're going to try to use the insolvency exception to exclude the remaining debt. In this case they are able to. The one thing I want to point out is on Form 982 which is on page 17. You'll notice that they check the box on line 1B for the insolvency, and on line 1E for the qualified principle residence indebtedness; they're able to exclude the full 750,000 of cancelled debt. That's done on line two. Since they no longer have basis in the residence there's no entry on line 10B. And they only have \$18,000 dollars of basis to reduce on 10A. So you'll notice these two numbers don't match. They don't need to match..

I'm going to have Curtis talk to you about the impact that the low-income taxpayer clinic is seeing.

Curtis:

Good afternoon. My name is Curtis Raven. I'm an attorney with Gulf Coast Legal Services. At Gulf Coast we have what is called the low-income taxpayer clinic. For those of you who don't know, the tax clinics represent the taxpayers in IRS controversies. Generally we deal with low to moderate-income taxpayers. . As participants, you may be interested in maybe participating on a pro-bono panel to help us represent some of these taxpayers in your spare time. Also you may have interest in referring clients to us as well that may not fit that description in your practice. So that's always available to you. The low-income taxpayer clinics are listed on the irs.gov website, with the local phone numbers of each of your clinics. I was asked to come here today to talk about some of the practical applications of dealing with COD income to help you untangle some of these tax controversies.

Generally what happens is because the taxpayer is in an extremely stressful situation, they might be in foreclosure or otherwise, so what happens is they're basically kicked out of their house. So what happens next is they forget to put their change of address in with the post office. So generally tax preparers who are preparing the taxpayers taxes never get that 1099C. So about five or six months later after tax season they get an IRS notice which says that they owe all kinds of tax liabilities to the IRS. So they come to you, they come to your office. They're extremely – now they're

even more distressed because they got the double-whammy. So you're trying to figure out where this income's coming from. So generally you can go back and look at some of the property records and try to ascertain what's going on. On the 1099C the financial institutions have to list out the fair market value of the property.

Generally if you can get a copy of that from the bank you can write a simple letter addressing the situation, especially if the fair market value is greater than the debt cancelled. That usually alleviates that problem very quickly. You can get some relief for your taxpayers. Under the Mortgage Debt Relief Act, gross income from the cancellation of debt is excluded from gross income if the debt discharged is from a qualified principal residence. Most of you are probably from Florida as practitioners. In those counties you can obtain those property records most of the time online or else you have to seek it out otherwise. But those – you'll need those documents in order to support the substantiation of the fair market value or if it's a qualified personal residence.

Another way you might consider refuting the COD income is by challenging the reasonableness of the fair market value of the bank's determination of your property. Evidence of the true fair market value of the property may be ascertained by monitoring the subsequent lender's sale of the foreclosed property and by monitoring the resale of the property by a third party who bought it from the lender. Also, taxpayers may document the fair market value by obtaining an independent appraisal before the foreclosure process occurs.

As you know, many of the banks are in deep financial situations right now and so they're trying to get rid of these foreclosed properties off their books. So they may in turn just try to discount the property's value of those to sell those to investors and other people. But due to the situation these short sales may not be the true fair market value so you may have to try to substantiate the situations otherwise.

Obtaining the bankruptcy records of the taxpayer will also allow the taxpayer to avoid COD income if the debt is discharged as part of a court approved bankruptcy plan. Bankruptcy records are available online at the federal courts. You may have to obtain an online account to pull those records or otherwise you'd have to contact the clerk of the court. I hope these practical applications of COD income will help your practice. Thank you very much.

Maria:

Good afternoon. I'm Maria Anderson, policy analyst for Wage and Investment Automated Underreporter, otherwise known as AUR. AUR is one of the major compliance programs. It is a matching program intended to improve voluntary compliance, address the tax gap, and help taxpayers better understand their tax related responsibilities. The AUR program matches amounts on forms W2, Form 1099, Schedule K1, Form 1098, Form 5498 series payer information documents against amounts reported on individual tax returns. The AUR program is worked in six campuses nationwide: Atlanta, Austin, Brookhaven, Fresno, Ogden, and Philadelphia. Although the cases worked in each campus are site specific, the AUR system is programmed with universal case access which allows the AUR cases to be viewed and/or worked in any of the AUR campuses.

Cancellation of debt is considered taxable income when a debt owed is discharged and is otherwise not excludable from gross income. As mentioned earlier, cancellation of debt exclusions include bankruptcy, insolvency, qualified farm debt, qualified principal residence indebtedness, Mortgage Forgiveness Debt Relief Act of 2007.

For additional information regarding these exclusions please refer to Publication 544, Sales and Other Disposition of Assets under Foreclosure and Repossessions; Publication 908, Bankruptcy Tax Guide, or refer to the IRS government website at www.irs.gov, key words "foreclosure" and "debt cancellation". File Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, to report applicable exclusions. The Mortgage Forgiveness Debt Relief Act of 2007 allows individuals to exclude from gross income any discharges of qualified principal resident indebtedness. This exclusion applies to discharges made after 2006 and before 2010.

Cancellation of debt cases are created when a mismatch is detected during the initial computer matching program between the amount of cancelled debt, Form 1099C, box two, and amounts reported on the tax return, Form 1040, line twenty-one. With few exceptions, every case selected to be worked in the campuses undergoes a manual screening process by which tax examiners review the payer information and compare it against amounts reported on the tax return in an attempt to reconcile the initial systemically identified discrepancy.

Tax examiners utilize the guidance provided in Internal Revenue Manual 4.19.3 as well as publications and Internal Revenue Code

and regulations to assist them in their attempts to reconcile the discrepancy. If the discrepancy is resolved, the case is closed off of the AUR system with no taxpayer contact. If the discrepancy cannot be resolved, a proposed new tax liability based on the under reported income is determined, and a contact letter, generally a CP2000 notice, is generated. If your client receives a CP2000, review the tax return and compare it to the issues raised on the AUR notice.

If after reviewing the entire AUR notice, you have questions that are not addressed on the frequently asked questions page or do not fully understand the notice, call the toll-free number provided to speak with an AUR representative. Respond by the due date listed on the notice. If you need additional time, call the toll-free number provided to request an extension.

If you agree to the notice, sign the consent to tax increase. Both signatures are required on married filing joint returns. Pay the balance or complete Form 9645, Installment Agreement Request. If you disagree with the notice, check options two or three, partial or full disagreement on the response page of the CP2000 and respond to each item that you disagree with. Provide your explanation in a signed statement. It is not necessary to submit a Form 1040X, Amended Return. You may provide revised additional forms and or schedules due to additional expenses or other allowances relating to the underreported income. If appropriate, provide copies of any supporting documentation, for example corrected payer documents, payer statements that support the amount reported as taxable.

Attach your explanation, revised forms or schedules, and/or supporting documentation behind the AUR notice response page and return them in the envelope provided. It is very important to include the response documentation with the copy of CP2000 to reduce misrouting or delays in delivering the correspondence to the AUR department. If a response to the CP2000 is not received then a statutory notice of deficiency will be issued. AUR follows a strict disclosure protocol required of all IRS employees to protect taxpayer confidentiality. Filing Form 2848, Power of Attorney, authorizes an individual to act as a representative for the taxpayer.

To protect taxpayer privacy, some form of authorization is necessary for disclosure purposes before an IRS employee can provide information to any third party. Third party designee check box authority on Form 1040, 1040A, and 1040EZ does not apply to compliance issues, including AUR.

Matt:

Thank you Maria. I think we've heard a lot of great information on a very complicated topic. I think the panel did a great job. We also need to point out that Publication 4681 is a very detailed publication and can answer a lot of your questions. Thank you very much for attending this cancellation of debt presentation and we hope it was informative for you. Thank you.

[End of Audio]