


## Review Questions and Final Exam

Course name:	<b>Cancellation of Debt - Tax Year 2008</b>
Course number:	1015N.08
Number of questions:	Review 15 Final exam 15
Prerequisite:	None
Course level:	Basic
Recommended CPE credit:	3 CPE hours
Recommended study time:	3 hours
Course format:	Interactive self study CPE credit calculated as 100% of total study time (i.e. 50 minute hour)
Reference text:	<a href="#">IRS 2008 Publication 4681 Canceled Debts, Foreclosures, Repossessions, and Abandonments and related video transcript (free download)</a>  24 pages
	 <p>Department of the Treasury Internal Revenue Service</p>
Subject classification:	Taxation
Course last updated:	May 20, 2009
Learning objective:	Gain an understanding of the federal tax treatment of canceled debts, foreclosures, repossessions, and abandonments.  Also review the general rule requiring canceled debt to be included in income, exceptions to the general rule, exclusions from the general rule and the ordering rules for reduction of tax attributes.
Instructions:	This copy of the exam can be used to answer questions while <b>offline</b> . Please note that you will still need to enter your answers online by logging into your course.

1) Generally, if you owe a debt to someone, and they cancel your debt, the debt cancelled is NOT considered income because you did not receive cash or cash equivalents.

True  
False

2) When you take out a mortgage on your home, the lending institution reports the funds paid to you to the IRS via a Form 1099 L.

True  
False

3) James got behind on his Hummer payments because he had to spend so much money on gas.

He voluntarily turned it back into the dealer, the dealer sold it and the dealer forgave the \$2,200 remaining balance of his loan.

James may have taxable income for the amount of the cancelled debt.

True  
False

4) Your daughter's voice teacher finances the \$4,400 cost of her basic one year training. You are personally liable for the loan, which has an interest rate is 10% and a term of 4 years.

After completing the one year training course, your daughter loses interest, and the voice teacher elects to forgive you the \$3,200 balance remaining on the loan.

The teacher is required to send you a 1099-C for the cancellation of debt.

True  
False

5) Jordon took out \$25,000 in student loans while attending Texas A & M University. His loan contained a provision that if he worked for a certain period of time in certain professions, his loan would be forgiven. After graduating, he worked for "Teach for America" for two years, which met the conditions for loan forgiveness.

Jordon WILL have income from cancellation of this debt, for federal income tax purposes.

True  
False

6) Your company, Hilarious Headbands, buys boxes of feathers on credit to use making the headbands. Due to a sudden trend to shaved heads, you experience a sharp decline in revenue and

are unable to pay your suppliers. The feather supplier forgives 50% of your balance due. You use the cash method of accounting. This forgiveness of debt results in reportable income for your company.

- True
- False

7) Jeremy Jones had \$10,000 in debt cancelled in a title 11 bankruptcy case, as a result of a bankruptcy plan approved by the court.

Jeremy must report the debt cancellation on his tax return using Form 982.

- True
- False

8) Farmer Vern runs a farm (Vern's Vegetables) as well as a vest making factory (Vern's Vests). Due to changes in fashion, Vern has received 75% of his gross receipts for the past 4 years from Vern's Vests. Vern bought a new tractor a few years ago from his brother, with a 5 year note payable to his brother for the purchase. Since his farm hasn't been doing well recently, he defaulted on the loan and his brother forgave him for the balance. Vern CAN EXCLUDE this canceled farm debt from his income.

- True
- False

9) Our archrival, boringcpe.com, purchased their website name for \$35,000 at a domain name auction. They financed this purchase with a loan. Unfortunately, their students never finished any of the courses because they fell asleep while taking the exams.

The company defaulted on their loan due to lack of revenues, and the loan balance of \$34,000 was forgiven.

BoringCPE CANNOT elect to exclude this canceled business indebtedness from income.

- True
- False

10) Julie and her husband Judd bought a home in California for \$3,500,000, using a \$500,000 down payment and a \$3,000,000 loan. Their house was foreclosed and the \$2,800,000 balance on her mortgage debt was canceled. Julie and Judd CAN exclude the full \$2,800,000 mortgage debt cancellation when they file their joint tax return.

- True
- False

11) Samantha's riding lawn mower was destroyed during a storm in Kansas in June, 2008. This property damage is considered to have occurred in the midwestern disaster area. The lawn mower was originally financed by Sears' finance company, the debt was canceled in November 2008 and Samantha did receive a 1099-C. Samantha can exclude the canceled debt on her tax return.

- True
- False

- 12) The order in which you reduce your tax attributes depends on the AMOUNT of the canceled debt.  
True  
False
- 13) If your home is foreclosed, you could still realize a gain.  
True  
False
- 14) Shelley purchased a Jeep for \$21,000 and was not personally liable for her Jeep loan, although the vehicle was used as collateral. When the vehicle was repossessed and sold, the bank realized \$10,000 which was \$4,000 less than the outstanding loan balance of 14,000. Shelley has an \$11,000 non deductible loss.  
True  
False
- 15) Quik Typing In Process, Inc. abandoned 15 IBM Selectric typewriters by leaving them at the curb in front of their office. QTIP paid cash for the typewriters and their basis in the typewriters was \$1,500 at the time of abandonment.

This abandonment results in a long term capital loss of \$1,500 for this company.

- True  
False

Exam Name: Cancellation of Debt —Tax Year 2008  
--Final Exam

- 1) The acronym “COD” income refers to:  
a) Cash on Delivery  
b) Current Owed Debt  
c) Collectible on Demand  
d) Cancellation Of Debt
- 2) The National Taxpayer Advocate discusses how forgiveness of mortgage debt affected more than \_\_\_\_\_ taxpayers in 2007.  
a) 50,000  
b) 2 million  
c) 200 million  
d) 5 billion
- 3) If the taxpayer receives a Form 1099C for debt forgiveness, the taxpayer:  
a) Must report 100% of the debt forgiven as income on his 1040.  
b) Should report only any taxable portion of the debt forgiven on his 1040.  
c) Need not report any amount, if he is a cash basis taxpayer, and no cash was received.  
d) Does not report any amount from the 1099C as this is an “information only” form.
- 4) A taxpayer may exclude cancellation of debt income in each of the following situations EXCEPT:  
a) Mortgage debt cancelled in July 2008

- b) Insolvency as measured immediately before cancellation of debt
  - c) Bankruptcy filing resulting in discharge of the debt
  - d) Nonrecourse loan cancelled, and lender allows taxpayer to keep the property
- 5) If you qualify to exclude income due to cancellation of debt, you must file \_\_\_\_\_ with your return.
- a) Schedule D
  - b) Form 4681
  - c) Form 1099C
  - d) Form 982
- 6) You should receive a Form 1099C if a financial institution cancels a debt during the calendar year of:
- a) \$250 or more
  - b) \$600 or more
  - c) Any mortgage amount greater than the fair market value of the property
  - d) Any amount up to \$2 million
- 7) Sam Johnston owed \$3,400 in back interest on his mortgage loan. The lender cancelled both the \$3,400 unpaid interest and the \$325,000 loan balance. Sam's potential cancellation of debt income is:
- a) \$ 3,400
  - b) \$321,600
  - c) \$325,000
  - d) \$328,400
- 8) The Form 1099A is provided to taxpayers for all of the following EXCEPT:
- a) Foreclosures
  - b) Abandonments
  - c) Refinancings
  - d) Repossessions
- 9) Marla Oaks walks into your office with a 1099C. Box 7 of the 1099C contains the amount of \$595,000 as the fair market value. You must use the FMV shown when calculating taxable gain or loss.
- True  
False
- 10) When calculating a client's insolvency, include all of the following EXCEPT:
- a) Paycheck received the day after the debt was discharged
  - b) IRA account balances
  - c) Savings account balance
  - d) Accrued property taxes for the year
- 11) The maximum amount of qualified principle residence indebtedness:
- a) is \$1 million if you are married filing jointly.
  - b) is \$2 million if you are married filing jointly.
  - c) depends on when you purchased your residence.
  - d) is based on average home prices in your area.
- 12) Mary Ann Moviestar financed her \$1 million one bedroom apartment in Malibu with a \$900,000 loan.

She subsequently refinanced it with a \$1,000,000 loan to finance adding a California Closet system to accommodate her wardrobe.

After she fell on hard times, her lender foreclosed, sold the apartment for \$790,000, and canceled the \$210,000 balance of the debt.

The maximum amount that Mary Ann can exclude using the qualified principal residence indebtedness exclusion is:

- a) \$ 110,000
- b) \$ 210,000
- c) \$ 900,000
- d) \$1,000,000

13) If you want to challenge the reasonableness of the fair market value shown on your 1099C, evidence of FMV could be obtained by reviewing the lender's sale of the property, together with a subsequent resale of the property by a third party who bought it from the lender.

- True
- False

14) If your client receives a CP2000 notice from AUR, this indicates:

- a) Your client has cancellation of debt income that cannot be excluded under the Mortgage Forgiveness Debt Relief Act.
- b) There was a mismatch between the amount of cancelled debt reported on Form 1099C and amounts reported on the tax return.
- c) You should advise your client to file an amended return.
- d) Your client should pay the tax liability shown immediately, and appeal later to avoid late payment penalties.

15) You must respond to the AUR CP2000 notice of tax deficiency by the deadline as no extensions are allowed.

- True
- False